PRICE CONTROL

Government Intervention or the Free Market?

by

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CONTENTS

9 Diagrams in Text

"The whole Roman world was being slowly strangled with good intentions. The bureaucracy had grown so highly organised and efficient, so nicely ordered through its various grades of official life, that everybody walked in leading strings to the music of official proclamations. . . . The triumph of this system may be seen in the famous Edict of Prices issued by Diocletian in A.D. 301. Here we find scheduled a maximum price for every possible commodity of trade and a maximum wage for every kind of service. Death is the penalty for any trader who asks, or for any purchaser who pays, a higher price. . . . This delightful scheme was evidently the product of a highly efficient Board of Trade which had sat late of nights over the study of statistics and political economy."—J. C. STOBART, *The Grandeur that was Rome*, 1912.

"The real price of everything, what everything really costs to the man who wants to acquire it, is the toil and trouble of acquiring it." —ADAM SMITH, *The Wealth of Nations*, 1776.

PREFACE

THE British economy faces a crisis. For the past two hundred years trade has developed under a system of private enterprise within a general framework of government regulation. During those years Britain became a great manufacturing nation always in the van of progress. She improved her standard of living by her own efforts and that of the rest of the world by her example and by the transfer of capital and enterprise abroad.

Of recent years government intervention has greatly increased and the operation of private enterprise has been much restricted. It is generally agreed that we cannot remain in the present half-way stage. Either we have an increase in government intervention or we have a progressive freeing of the economy. This book examines one aspect of government control, namely, the control over the prices at which goods are bought and sold.

The market mechanism has fallen into disrepute. It has even been claimed that we have abolished the laws of supply and demand. To understand how government affects different classes of the community it is necessary to examine the price system. Chapters I–III are a brief summary of the economic theory of market price. They have purposely been kept short as a background to the study of the effects of government interference with market prices. The various reasons for government control are examined in Chapter IV.

Later chapters discuss matters that are extremely controversial and on which very opposing views may be sincerely held. Yet there is an increasing disquiet over the workings of some of the price controls and the policies require examination and discussion. This is particularly so as the implications of the policies are not always fully understood.

It is contended here that price control creates the Black Market, or at least that it creates the conditions under which the Black Market flourishes. The shortages experienced in many commodities are a result of the policies that are designed to control these very shortages. The operation of price control often leads to results that were not part of the government's intention.

PREFACE

The writer thanks those who have answered inquiries on points affecting particular trades. Acknowledgements to reports, etc., are made in the text. None of these people are in any way responsible for the opinions expressed in this book.

One warning must be given to the reader. In an age when two Budgets are introduced in one year and when changes in controls take place daily, it is impossible to be completely up-to-date. Facts contained in this book are used to illustrate the arguments and are not to be regarded as a catalogue of existing controls. For these the reader will have to consult Trade Journals or the numerous Price Orders that in themselves make some contribution to the paper "shortage."

F. R. J. J.

JUNE, 1949.

CHAPTER I

MARKET PRICE

BEFORE attempting to work out the effects of government control of prices it is necessary to be quite clear as to the meaning of price in economic theory. It will be necessary to evaluate what is market price, what it represents, how it arises, and what is its effect upon the economic system.

Market price is the amount of money which the buyer has to give up to get the commodity he wants. It is the cost of the commodity to the buyer. Also, it represents the amount of money which the seller requires to induce him to part with his goods. In other words the cost of obtaining money, for the seller, is measured by the commodity which he has to hand over in exchange. Price, therefore, is a rate of exchange between money and a commodity. If apples are, say, 6d. a pound, it means that a buyer of apples has to surrender 6d. to obtain a pound of apples, and a person who has apples in his possession is able to obtain 6d. for a pound of them. Further it represents, assuming that both buyer and seller are in their right minds and know what they are doing, that the apples give at least sixpennyworth of satisfaction to the buyer, and that the seller is quite willing to part with the apples in exchange for the sixpence.

Barter

Exchange, of course, need not be undertaken only by means of money. It is possible to exchange goods directly, i.e. by barter, and money then does not enter into the calculation. But there is still a rate of exchange. If, in a primitive community, corn is exchanged for fish and one pound of corn has to be given for two pounds of fish then the rate of exchange between the two commodities may be expressed in terms of each other. The price of obtaining one pound of corn is two pounds of fish, i.e. corn costs two fish instead of so many pence a pound, and the price of obtaining one pound of fish is half a pound of corn, i.e. fish is represented by $\frac{1}{2}$ corn.

If the seller of apples obtains 6d. for his pound of apples, he

can use that 6d. to buy some other commodity, say, a loaf of bread, if bread is 6d. a loaf; and what he has done, indirectly, is to exchange his pound of apples for a loaf of bread, in exactly the same way as the "seller" of the corn has "bought" fish with his commodity, only in a direct way.

There are many disadvantages to direct barter between commodities to obtain the things we need in exchange for the things we are willing to give up to obtain those things, hence the invention of some form of money to act as a medium of exchange to facilitate business transactions. But all buying and selling for money is only an indirect way of getting something else which we need. By comparing the price at which we sell our goods with the price at which we buy the other goods we want we are able to fix the rate of exchange directly between the two sorts of goods. If we are selling a pound of apples for 6d. and we buy a loaf of bread for 6d. we are in reality exchanging a pound of apples for a loaf. Or, if we sell our own labour for 2s. an hour, in order to obtain bread to eat, the price of bread may be quoted as 6d. a loaf, or as the product of a quarter of an hour's work.

Because we are so accustomed to using money for our everyday transactions the essential nature of the exchange of goods and services between different people is often forgotten. Money price becomes invested with all sorts of properties and ideas if this essential meaning is forgotten or allowed to slip into the background. While money is a great help to trade, it is a cause of confusion in economic thinking.

The market mechanism

The demand for any commodity on the market is made up of the combined demands of all people who are desirous of possessing that commodity. The supply is made up by all those who have the commodity and are willing to sell it to others. Generally, the lower the market price the greater the amount that will be demanded. If price falls the demand increases because those who are buying the commodity find that with the lower price they are willing to use more of that commodity. Demand also increases because the lower price brings on to the market people who previously, at the higher price, did not wish to spend their money on that commodity.

This is generally expressed by saying that the demand curve for a commodity is a falling one, i.e. it falls from left to right. The reader unaccustomed to economic text-books is advised to study the illustrations carefully. In Diagram 1 OX represents quantities on the market. OY represents various prices. The line DD_1 is the demand curve for the commodity. As price falls the demand increases so that the curve which is traced out by the relationship between price and demand is falling from left to right. It represents the conditions of demand for the commodity at that particular moment. It may be a steep curve, showing that a great fall in price causes a comparatively slight effect on the amount which is demanded, or it may be more horizontal, showing that a slight fall in price results in a greatly increased demand. Or the curve may exhibit various peculiarities. It may fall steeply at first, showing that a fall in price has little effect on the demand, and then it may flatten out, as the lowering price brings more and more people on to the market to buy the commodity.

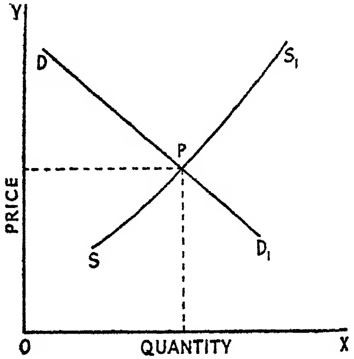

Diagram 1

Short period supply and demand OX represents quantities on the market, and OY, prices at which these quantities are bought and sold. DD_1 is the demand for the commodity and SS_1 the supply. The market price is fixed at the point P where supply and demand are equal.

In the same way the supply curve for a commodity is usually a rising one, that is, it rises from left to right. If a low price is offered, owners of the commodity may prefer to keep the commodity, either for their own use or because they may hope that the price will rise later and they will be able to part with what they possess on more advantageous terms. If the price rises, some sellers will give up more of the commodity; other sellers who would not have sold at the former price will be induced to give up their commodity because on the better terms now offered they can obtain more money.

Equality of supply and demand

Market price means nothing more than that with certain given conditions of demand among the buyers, and certain given conditions of supply among the sellers, a price will be established at which the demand and the supply are equal at this market price. The price and quantity which is bought and sold will be determined at the point where the two curves SS_1 and DD_1 intersect.

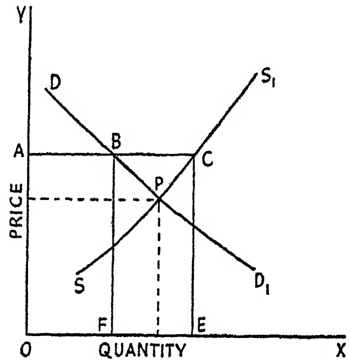

Diagram 2

As in Diagram 1, P is the equilibrium price at which supply and demand are equal. If the price is fixed at A the amount AC (=OE) will be offered, but the amount AB (OF) will be demanded. Therefore, BC (FE) will remain unsold.

The market is in equilibrium. While this simple diagram expresses a truism there is more in it than that and some very useful information can be drawn from it. If the price is higher than this market price the market is no longer in equilibrium and the general forces of the market will assert themselves to restore conditions of equilibrium. This can be seen from Diagram 2. Suppose that the conditions of demand and supply are the same as in Diagram 1, but that the price is at A instead of at P, the equilibrium point. It may be at A because sellers think that that is the price which they can get or because buyers think that that is the price which they will have to pay to obtain possession of the commodity, or because the price is "fixed" at that point.

At the price A the demand for the commodity is measured by the quantity AB but the amount which is offered on the market at that price is measured by the quantity AC. (The quantities OF and OE respectively.) Buyers take up the amount AB (or OF) and sellers realise AB, as the same amount must be bought and sold. But, at the price A, sellers are perfectly willing to offer AC for which there are no buyers. If, however, they wish to sell BC (FE) they must offer that quantity at a lower price. Thus the price will fall until more is obtained by the buyers and their demand

moves along the DD_1 curve and more is sold by the sellers so that price and quantity changes will bring the price to P. The amount bought and sold is brought to the point of equilibrium between the demand and the supply of the commodity.

In the same way it can be seen from Diagram 3 that if the price is OA instead of OP the demand for the commodity is AC *at the price of OA*, while the quantity which sellers are willing to offer is only AB, *at the price of OA*. There is therefore an unsatisfied demand of BC. If buyers bid up the price, as they are assumed to be willing to do from the conditions expressed in the diagram, price will rise until it is at P, where demand and supply are once more in equilibrium.

Where the money price is below the equilibrium price the demand, at that price, is greater than the supply which will be offered at that price. The market price is the price at which existing demand and supply are equal. There is no inducement to the buyers or to the sellers to change the amounts which they wish to take off or to put on to the market. Price will therefore tend to go to that figure where the amounts demanded and the amount supplied are equalised and everyone is satisfied, in that he does not wish to change.

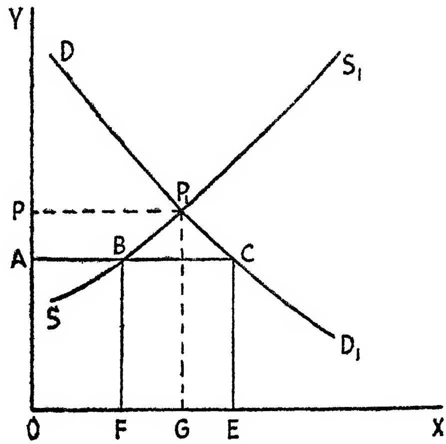

Diagram 3

OP is the equilibrium price at which supply and demand are equal. If the price is fixed at OA the amount AC (OE) will be demanded but only AB (OF) will be offered. Hence there is a "shortage" on the market of BC (FE).

Reactions of the seller

These diagrams will explain certain economic phenomena which often seem puzzling in themselves. It often happens that the price offered for a certain crop is less than the farmer expected. But instead of selling it for what it will fetch on the market he

prefers to plough it back into the ground. The price is so low that the crop is of more value to him than the cash price offered on the market. If we take it that he "sells" all his crop at that low price it is worth while for him to buy it back from himself as a manure to plough into his land. (Naturally he will save the cost of gathering and marketing the crop which he ploughs back, so it is choice between a low price plus various expenses and buying in from himself a cheap means of adding humus to the soil.)

The fact that the seller of a commodity can be considered to be in the market for that commodity is a means of explaining the rising supply curve. Whatever commodity the seller is offering he may have a possible use for it himself, even if it is only to hold it from the market until prices rise. Where a seller at an auction puts a reserve on the article he may be said to be bidding for it up to that price.

Again, when sellers complain that there are unsold stocks, that they are unable to dispose of their goods on the market, the reason generally is that the prices are too high. Unsold stocks, as can be seen from Diagram 2, are a result of price being above the equilibrium point for the existing stocks on the market, in relation to the existing demand for the commodity. (There are special cases where the stock is so great that it could not be sold at any price.)

In the same way, when price is below the equilibrium there are always more buyers than sellers. Buyers complain that when price is controlled the goods disappear beneath the counter. What has happened is that if the control price is below the price which equates supply and demand, the market is bound to be out of equilibrium because supply and demand are no longer equal. If in Diagram 3 a maximum price of OA is fixed, instead of the natural price OP, conditions are now entirely changed. At OP there were OG buyers and OG sellers, but at the price OA buyers have increased to OE, while sellers have decreased to OF. At that lower price, not only have the number of people willing to buy been increased but some of the sellers have changed into buyers in that they prefer to keep the commodity for their own use. When strawberries are dear growers sell all they can to reap the advantage of the high price, but when they are cheap they prefer to eat some themselves.

Goods do not disappear under the counter because of the evil nature of shopkeepers, who are in business to sell all they can, but because at that particular price there are more willing buyers than there are willing sellers. Supply can never catch up with the demand. Far from the price control bringing fresh supplies on to the market for the benefit of the consumers it results in adding to the number of consumers and diminishing the number of sellers, thus aggravating the shortage experienced by the buyers.

Prices and quantities

Price taken by itself is meaningless. The demand for a commodity and the supply of a commodity, taken by themselves, are meaningless. Price is a result of the supply and demand at a particular moment and the supply and demand are themselves influenced by the price. Supply, demand, and price taken together express a relationship in a market for a commodity at a given moment. The price is a means of measuring the supply and demand; but the supply and demand are both functions of that price.

Price measures the forces on the market, and its primary function is to give us a short answer, generally in terms of money, to the question as to what is the condition of the market at a given moment. As the mercury in a thermometer measures the temperature of the air so does the price measure the market. If prices are "high" it is because market conditions cause high prices just as it is warm air which causes the mercury to rise and not the height of the mercury which makes a summer.

Kinds of money

Mention has been made of the use of money as a measure of price and as a convenient medium for the exchange of different commodities. For money we can use any commodity we choose, and in fact in the course of history many different things have been used for this purpose. When we refer to the price of a commodity as being so many shillings we are using shillings as a term of convenience. We could just as easily, as is being done in parts of the world to-day, express the values of commodities in terms of cigarettes or some other commodity which is generally acceptable. Or we could use as a measure, and we could draw our wages or

salaries in terms of clothing coupons or bread units. We would then measure the value of certain commodities in the clothing coupons which they would purchase, in the same way as clothing coupons have been valued at the present day in terms of so many shillings each. It has even been suggested that certain companies manufacturing goods which are "in short supply" should pay their shareholders' dividends in terms of commodities.

When we wish to compare prices at one period with those prices ruling at another period an added complication arises. The unit with which we measure may change. If the property of mercury altered, so that a given rise in temperature of the air caused it to rise higher in the thermometer, it would be necessary to allow for this fact in comparing the temperatures at one year with another. In fact, market prices often do change not because conditions of supply and demand have altered but because the unit in which we measure the prices has itself altered. To compare the price of a commodity now with its corresponding price before the war is complicated by the fact that money does not have the same value as it had in 1939.

In considering questions of price there is this added complication which is very important at a time when general values are changing. The relationship we have to consider is the relationship between supply, demand, price and money. The price of a commodity may be influenced by movements upwards or downwards in the supply or demand for the commodity, and by movements in the value of the money unit which we are using.

Choice of commodities

Market price performs another useful function. So far we have been considering the supply and demand for one particular commodity and the terms upon which it is offered on the market. But consumers are interested in many commodities, and a function of the price mechanism is to express the relationship between different commodities offered to the choice of the consumer. Just as the price of a commodity cannot be considered in a vacuum without taking considerations of supply and demand and money into account, so the price of a commodity is meaningless without considering the prices of other commodities on the market.

If, as in the example on page 9, the prices of a pound of apples and of a loaf of bread are both 6d., it means that a purchaser with 6d. to spend can have either the apples or the bread. It measures the extent of his choice between the two commodities. The purchaser with a shilling to spend has the choice of either buying two pounds of apples, or two loaves of bread, or one unit of each commodity. If he decides on the latter choice, it means that he values the bread and the apples equally. If apples fell in price to 3d. a pound the consumer may buy more apples, i.e. he may continue to spend 6d. on the apples and buy double the quantity. Or he may be satisfied with the same amount of apples and buy another half a loaf of bread. In other words, the amount of bread which he buys not only depends upon the price of a loaf but is influenced by the price of other commodities which he may want to buy. Taking all the commodities on the market open to the consumer's choice, the price of any one of them and the demand for it is influenced by its own price, and also by the prices of all other commodities which are on the market. The prices, expressed in money, of all commodities show the conditions of demand and supply of those commodities on the market at that particular time.

While it is possible to have a general rise or fall in prices, due to changes in the value of money, it is not possible to have a general rise or fall in values. If both the prices of apples and bread double, so that apples are 1s. a pound, and bread is 1s. a loaf, both have altered in terms of money but the relationship between the two commodities, the terms of choice offered to the consumer, have not altered. For the same amount of money the buyer is still offered the choice of bread and apples on the same terms as before. If he now has 1s. instead of 6d. he is not a penny worse or better off.

Price measures the real terms upon which the consumer is able to obtain what he wants in exchange for what he has to offer the market, and will be the same measure whether we count in terms of gold or paper money or labour units or what you will.

CHAPTER II

THE REACTIONS OF PRICE ON THE MARKET

WHILE price is the result of market forces the function of price does not cease when it records the conditions of supply and demand. The analogy of the thermometer is not quite complete because, while the thermometer merely records the temperature of the air, price does more than just record. Supply and demand fix price but the resultant price reacts upon the conditions of supply and demand.

In the short period the conditions of supply are taken as fixed. In this period it is impossible to alter the amount that can be supplied to consumers. When a longer period of time is considered, then price is not a resultant force only, it is a cause of movement in itself.

It is some of the long period effects which are being considered here.

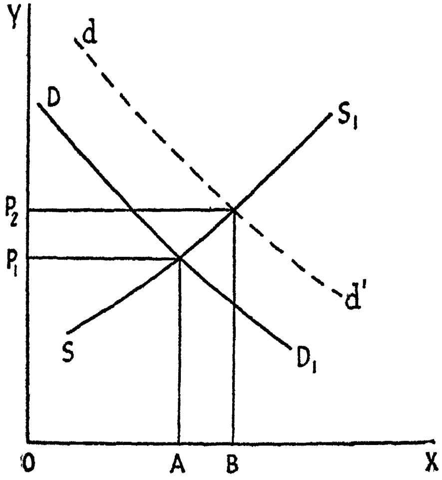

Diagram 4

An increase in demand is represented by a movement of the demand curve DD_1 to the right to a new position dd^1. Formerly, the quantity OA was sold at the price OP_1. The new demand curve intersects the supply curve at a higher point and the amount OB is sold at the price OP_2.

Increase in demand increases supply

If there is an increase in the demand for a commodity this will be represented in Diagram 4 by a movement of the demand curve DD_1 to the right to a new position dd^1. This means that for existing supplies consumers are willing to pay higher

prices or that for the same price they are willing to take more of the commodity off the market.

Price will rise from P_1 to P_2, and the amount sold will increase from OA to OB, but the matter does not end with these short period effects. The rise in price will add to the revenue of the producers of the commodity, and their profits will rise. If there is no barrier to increased production the tendency will be for the increased price to call forth increased production. If producers increase production the factors underlying Diagram 4 are no longer the same. The supply curve SS_1 represented the *then* existing supply on the market. As supplies have increased the curve SS_1 does not represent conditions at the moment. At the new conditions of equilibrium more will be offered at given prices and this is represented in Diagram 5 by the movement of the supply curve SS_1 to the right, to ss^1. This new curve will cut the new demand curve dd^1 at a lower point and price will fall from P_2 to P_3.

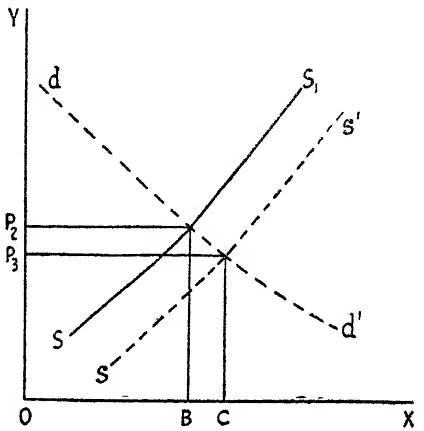

Diagram 5

The rise in price to OP_2 causes further supplies to be brought on to the market. This is represented by a movement of the supply curve SS_1 to the right to ss^1. This new curve cuts the demand curve dd^1 at a lower point and price falls from OP_2 to OP_3 and the quantity sold increases from OB to OC.

Thus the increased demand, by causing an increased price, reacts to bring about an increased supply, which in itself will lower price from its higher level. The relation between the original price P_1 and the newer price P_3 will be determined by the conditions of the supply of the commodity. If the increased production of the commodity leads to improvements in its manufacture, to better methods, to improved division of labour, or to the better use of capital, it may well be that the new equilibrium price will be lower than the original price. This has

been historically true with the production of many commodities over the last two hundred years.

If, on the other hand, the production of the commodity is rendered more difficult because of the scarcity of some of the factors of production necessary to bring it into being, the resultant price may be above the original price.

Decrease in demand decreases supply

In the same way a decrease in the demand for a commodity will cause its price to fall and it will then be less profitable to the producers. Some will cease production; others will cut down their production. The result will be that the supply on the market will be reduced. The reduced supply, interacting on the reduced demand, will cause a new equilibrium price. As in the case of an increase in demand the new price may be higher or lower than the original price, depending upon the conditions of supply of the commodity.

Changes in the demand for a commodity, either upward or downward, first of all affect price, and the price change itself will affect the supply of the commodity, bringing it into equilibrium with the newer conditions of demand, at a newer price. Price changes thus induce the correct supply relative to the demand for a particular commodity.

Effects of an increase in supply

Changes in the supply likewise will affect the price, and through price the demand will be affected. Let us take the example of an increase in the supply of a particular commodity. An increase in the supply means that for the same price inducement increased supplies are coming on the market. If, for example, there is a good harvest of a crop, there will be more of that crop offered by the producers at the existing price. In Diagram 6 supply and demand interact to give the price P_1. The new supply, an increase in the amount produced over what had been the previous crop, is represented by the new curve ss^1. Price falls from P_1 to P_2 and the amount consumed increases from OA to OB.

What happens will largely be determined by the slope of the demand curve DD_1. If the curve is "elastic" (where a small fall

in the price causes a larger increase in demand), the fall in price will be so much the less, and the amount bought so much the greater. If the curve is steep and "inelastic" the fall in price will be all the greater. The increased supply will largely affect the market by causing the price to fall instead of increasing the demand.

In either case, if the increase in supply causes a large or a small fall in price, it will be a signal to the producers of the commodity that an adjustment is required. Where the demand is inelastic, so that the total receipts obtained from selling the larger output at the much lower price are less than what was obtained from selling the smaller output at the higher price, this will generally cause production to diminish. Some producers will go out of business, thus reducing the supply, so that the price will later rise again to a new equilibrium point. The fall in price is an indicator to the producers that their product is now less highly valued by the market and that some of them would be better employed in producing another commodity which is better prized by the consumers.

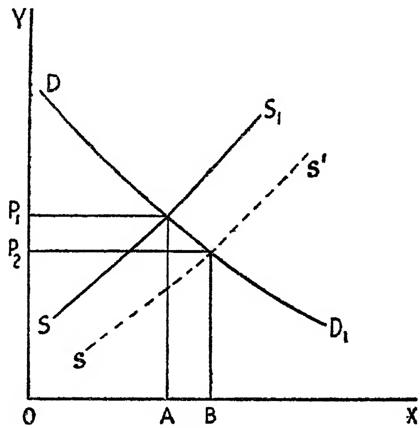

Diagram 6

An increase in the supply of a commodity is represented by the movement of the supply curve SS_1 to ss^1. This cuts the demand curve lower down and the price falls from OP_1 to OP_2 while the amount sold increases from OA to OB.

Effects of a fall in supply

Similar arguments may be adduced to trace the effects of a reduction in the supply of a commodity, owing to, say, a failure in the harvest. The reduced supply, acting on the same demand, will cause the price to rise. This will lead to a certain reduction in consumption. The price increase will be an indication to the

consumers that the product is more difficult to obtain, so consumption will have to be cut down. To the producers the price increase will be an indication that it will be worth their while to increase their supplies on the market; and, in general, the rising price caused by a diminution of the supply will lead, eventually, to an increase in the supply to take advantage of the higher price.

Not only is the price a result of the interaction of the supply and the demand but it is a powerful factor affecting these two market agencies. It is these powerful forces which are always tending towards equilibrium, and if for any reason the market gets out of joint the self-acting mechanism is there to correct it.

Markets are not perfect

While the above has been a general statement of the theory of the market mechanism, there are many adjustments to be made in practice. It is not to be assumed that this mechanism acts perfectly in an imperfect world. The forces of the market will *tend* towards equilibrium but the working out of the forces takes time. This gives rise to stresses and strains, which while certain in the long run, cause considerable trouble in that half-way stage between the short period of Chapter I and the long period of the present chapter.

Many of the difficulties occur in agriculture owing to technical reasons affecting the supply. If we take the case of a rise in price caused either by an increase in demand or by a failure in supply, this will lead to an increase in supply. The increase in supply will, however, not be regular or instantaneous. The increased price will cause farmers to increase production. In the case of some commodities this will bring forth an increased supply within a year, the period from sowing to harvest. In other commodities the increased supply will be delayed.

If there is an increased demand for rubber this will cause additional plantings of rubber trees, but it will cause no immediate increase in the supply of rubber. No rubber can be gathered from the fresh plantings until the trees reach maturity, which will take a number of years. Similar conditions apply in the case of coffee growing. There is a long time lag between planting and harvesting of the first crop. The new conditions may give

rise to permanently high prices over a considerable period, for several years, which will cause further annual plantings, over and above what is required to bring the price down to its original one.

Difficulty of an increase in supply

At maturity of the plantings there will be a large increase in the supply. In the meantime consumers may have become used to the higher price; they may have made adjustments in their expenditure; they may have found substitutes. The supply which was wanted several years ago may now come on to a market which does not require it to the same extent. Price will fall by perhaps more than the rise in price caused by the original shortage.

The high price which should induce further supplies may not always do so. If producers in the past have experienced the price fluctuations they may refrain from fresh planting. They may believe, possibly quite rightly, that as the rise in price is purely temporary, it is not worth the expense of the additional planting which will bring no results for some considerable time, and that when the additional supply comes on the market the price will break. This presupposes a knowledge of the market by the producers and the possibility of concerted action among them, which is seldom realised in practice. But it does open the way to government action to attempt to control the market on the producers' behalf.

Without concerted action each producer will be induced to extend his plantations, knowing that generally his addition to the supply will be a small proportion of the supply on the market, and that he will reap the benefit of the rise in price. It will be to his advantage that he increase his own production, as long as other producers do not do the same. If all act to increase their own production the total supply on the market will be increased, and there will be a fall in prices.

Difficulty of decreasing supply

Difficulties of adjustment also occur in the case of a reduction in the supply of a commodity. A fall in price is the signal for a reduction in supply, but the signal may not be obeyed. In many

cases a farm is not only a source of livelihood, it is also a home. If there is a fall in the price at which a crop is sold there may be no alternative open to the farmer but to continue in production. This is particularly true in the case of specialised production, where the farm produces one crop only for sale in the market. Where a mixed farm is being operated, it is possible to change from a commodity whose price has fallen to one of which the price is being maintained, but a farmer of a specialised crop for sale may have no other crop to which he may turn.

It may be that a fall in the price of a commodity has the opposite effect to that which would be experienced generally in industry. A fall in the price of wheat on a specialised wheat farm reduces the farmer's income. The only way in which he may maintain his income is by selling more wheat at the lower market price. The result of the fall in price is to stimulate production, so that more is brought on to the market, which further depresses the price, as happened during the nineteen-thirties.

It is this type of adjustment which has been the cause of disequilibrium in the production of many of the primary agricultural products between the two wars, in wheat (from the specialised districts), in cotton, and in coffee.

The effect of income on demand

On the demand side there are also peculiarities to be noted. In general a fall in price will stimulate consumption of the commodity. There are cases where the opposite is the effect.

"The desire of food is limited by the narrow capacity of the human stomach," and a poor person spends a higher proportion of his income on food, especially on the primary foodstuffs, than does a richer person. A rise in income of a poor person means that less in proportion is spent on food, and a rise in the standard of living of a country means that a less proportion of wealth is devoted to purchasing the primary foods. Poor people eat more bread than richer people. Richer people and richer communities can afford a greater variety of diet and thus their need for the more filling foodstuffs is reduced.

A fall in price of a staple food which occupies a large proportion of the consumer's budget has a double effect. It means that the consumer can afford to buy more of that particular food,

which may stimulate consumption. Or the reduction in price will mean that with the same consumption more money is available for other commodities. If the extra money is spent on other foods, such as meat, less bread is required in the diet. The price effect is to cause an increase in the demand for wheat; the income effect is to cause a fall in the demand for wheat.

A rise in income will affect other commodities. Certain items of diet loom large in the expenditure of poorer people. The demand for margarine is greater for poor than for rich people. Although the latter could afford to buy more margarine, they prefer to spend their money on other commodities. A rise in income of the poor will cause an increased demand for butter but a lessened demand for margarine. Similarly, a fall in the price of margarine may mean that more may be afforded, or that the money saved may not be spent on margarine but on buying a certain proportion of butter, so that the total expenditure on fats remains the same but is distributed over more commodities.

Special cases

The simple analysis of market price in the two first chapters has therefore to be modified by the peculiar circumstances of the particular commodity under discussion. But the general proposition holds good, that the price is a potent factor in influencing the supply and the demand for the commodity. Changes in price give rise to the necessary adjustments required to bring about equilibrium. The process may take time, the results may be delayed, but the forces are acting continuously and in the right direction.

The forces apply generally to all markets, whether the markets are for necessities, for luxuries, or for labour and capital goods, but the analysis has to be modified to suit the circumstances of the individual case.

CHAPTER III

MONOPOLY PRICE

Competitive conditions

THE analysis in the previous chapters has dealt with normal competitive conditions and no account has been taken of the influence of monopoly on price.

The essential difference between competitive and monopoly conditions is that under competition the seller has no control over the price charged. If there are a large number of buyers and sellers price is determined by the interaction of the supply offered by this large number of sellers with the demand of the large number of buyers. No individual buyer or seller is sufficiently important in the market to make any difference to the quantity offered or demanded.

It makes no significant difference to the supply of wheat in the world market if any individual farmer doubles his production or if he goes out of production entirely. His production is so small a proportion of the total supply that any variation is unnoticed in the total. If he produces wheat at all, he must accept the price which is fixed by world conditions. Only if all, or a significant proportion, of the suppliers change their supply will the market be affected.

Where a seller produces a considerable proportion of the supply on the market, then he is able, by varying his supply, to influence the market price. In the extreme case, where there is one seller of the commodity, he has a monopoly and can determine the price at which the output will be sold.

Price and output

It is to be noted that if the monopoly supplier fixes the price he must accept the fact that buyers will alter the amount demanded at the price fixed. By fixing his price he fixes the amount of his sales. By charging a higher price he will generally reduce his sales; by charging a lower price he will generally increase his sales. His sales and his output are linked together. The seller

under competitive conditions, however, has no control over the price that he obtains. But he has control over his output, and he may sell as much or as little as he chooses at the current market price.

It is generally assumed that the seller under competitive conditions will continue to increase his output until the point is reached where the cost of additional production is equal to his additional receipts. The economist expresses this by saying that he balances his marginal receipts with his marginal costs, and both will be equal to the market price.

The general assumption is that the monopolist will act on the same principles. He will balance his marginal costs with his marginal receipts. But in his case his marginal receipts are under his control, because by varying his output he varies his selling price and so the amount which he obtains for each unit of the commodity sold.

The monopolist acts in no different manner from the seller under competitive conditions. Both attempt to do the best that they can do for themselves. But in the one case the seller can influence prices, in the other case he exercises no individual influence. The monopolist is no different species of trader from the other, but the circumstances under which he acts are different, that is all.

Monopoly and competition

The dividing line between competition and monopoly is one which it is difficult to draw in practice. Older economists assumed competitive conditions, and introduced monopoly as a peculiar case of special conditions where the normal analysis did not apply. Or they analysed conditions where sellers had an absolute monopoly of some product, and kept this analysis apart from the general stream of economic thought. Of recent years much progress in analysis has been made, so that there is now no sharp cleavage between the two bodies of doctrine. Theories of monopolistic competition (where "monopolists" are in competition with each other), and theories of imperfect competition (where competition between producers is not perfect for a number of reasons) have been developed in America and Britain, bringing together the two streams of economic thought

so that our understanding of many problems has been greatly improved.

No hard-and-fast line can be drawn between the two conditions. Where Farmer Brown is growing wheat his wheat is in competition with that of his neighbour. Both will sell at the same price in the same market. But there is one sense in which Farmer Brown has a monopoly. Although he is selling the same product, wheat, he is selling something different and special. He is selling Farmer Brown's wheat. Of course, it is just wheat, the same as any other farmer's. But if he is able to produce a slightly different type of wheat, or to induce the buyers to believe that he is selling something which is different from that of the other sellers, then he has produced for sale something different. He has, therefore, a monopoly of Farmer Brown's wheat.

While the example given is one which is not of importance in practice, there are many cases in which very similar circumstances give rise to conditions of partial monopoly. Wheat is a commodity which is very easily standardised. So although Farmer Brown may produce a brand of wheat which is different from that of his neighbour, his wheat can be graded and classified into a definite category, and it becomes part of the supply of wheat of that grade which is produced by a large number of different farmers, and he loses the monopoly. If he were producing not wheat, but grapes for wine-making, then small variations in the soil or climatic conditions would give rise to differences in the product. Different producers of very similar products will find that there is some appreciable difference between them, so that each finds a separate market. Hence it is possible for the seller to fix his price and to refuse the prevailing market price.

Monopoly and substitutes

In the same way all makers of the same type of motor-car are in competition with each other. But in so far as there is some difference between each particular make it can be said that each manufacturer has a monopoly of his own product. It is a monopoly which is conditioned by the fact that there are some very close substitutes for his product.

The demand curve for the product of each manufacturer

will be a falling one, as distinct from the competitive curve where the demand curve is horizontal to the individual producer. But the manufacturer will have little latitude for monopoly price fixing because of the close substitutes available. The demand curve to the producer will not be falling at a great rate; the closer the substitutes the more nearly the demand curve will approach the horizontal.

Some degree of monopoly is to be found in all competitive conditions, and all monopolies are conditioned by the fact of the possibility of substitutes, which give a limit to the price-fixing policies of the monopolist.

In the long run the monopolist has to face the position that if he restricts his supply so as to obtain too high a price, consumers will find other uses for their money, i.e. money will be spent on substitutes, and the demand for the product will decline.

Conditions of monopoly

Monopoly may take several forms. There is the monopoly enjoyed by all sellers of a product. Each seller has the monopoly of his particular supply, whether it is the product of his own coal mine or the product of his own labour. Where the market is a well organised one this is of little practical use to the seller because the substitutes are so close that competitive conditions are operating.

Monopoly is likely to arise where a producer has the virtual control of a raw material which is found in certain places only in the world. It is easy for one person to gain control of a mineral which is to be found in a certain locality only and the world market is dependent on this one source of supply. It is comparatively easy for groups of producers to be associated controlling materials found under these conditions, so that even where the mines are in separate ownership producers act together so that a monopoly is created. The Ruhr coalfields are an example of this, and in an earlier age the Newcastle Coal Vend controlled the sale of coal from the Tyne.

Monopoly is also likely to arise where the conditions of production are such that there are considerable economies in manufacture on a large scale, where an increase in the size of the establishment leads to such economies that one producer is able

to undercut his competitors and so gain the whole market. Or where the conditions of production are such that the total output of the commodity is provided by a small number of large firms, it often happens that an amalgamation or working agreement is brought about, so that the supply comes under the control of a group and monopoly is introduced into that industry.

Monopoly and the law

The ownership of patents and trade marks and exclusive trading licences which are given by governments also leads to the producers of the particular commodities being in possession of a monopoly. This may happen on a large or on a small scale; not all monopolies are the result of large-scale enterprise. Monopolies may be quite local in character, but in that smaller market the monopoly is just as real to the consumers.

Special privileges of manufacture or the right to import or to export commodities have been given to private individuals since the time of Edward III. In the time of Elizabeth and James I monopolies came to be given, not for commercial reasons, but as personal rewards. The practice gradually passed out—subject to evasion of the law—because of the opposition of parliament. The granting of monopolies is retained in the law of patents to inventors and in the regulation of copyrights.

In general it may be said that the law and parliament have been averse to the granting of monopolies to individuals down to quite recent times. Now it is quite common, and it will be the task of later chapters to examine the economic effects of some of this recent legislation. But until the recent change a considerable part of the attention of governments has been taken up with trying to suppress or to control monopoly.

Potential competition

Monopolies in private trade are always conditioned by the possibilities of competition. Actual competition may not exist, but the potential competition may be there. Monopolists may be governed in their policies by the fact that if they restrict output or raise prices the higher prices will attract into the trade other people who would not be attracted into that trade by a low price. The effects of competition may be evident without there being actual competition.

If, however, entry to a trade is restricted or even if it is made difficult, monopoly conditions may result, although it is not possible to point to any group who possess an actual monopoly. The people in that trade may be in competition with each other, and the trade or industry may be apparently competitive, but restriction on entry will make conditions not fully competitive. If there were easier entry, the number of competitors would be larger and price would be lower and output greater. One of the important monopolistic devices is to restrict entry to a trade while preserving competition between the members who are admitted to that trade.

Apprenticeship schemes, while they may make provision for the training of entrants, have the result of making entry more difficult and therefore of cutting down the numbers of people who practise that particular occupation. "The limitation of the number of apprentices restrains it (competition) directly. A long term of apprenticeship restrains it indirectly, but as effectually, by increasing the expense of education."[1]

Similar conditions apply to restrictions of entry to particular trades by marketing devices or acreage levies on particular crops. Even though the existing producers are not in an open or a tacit monopoly agreement, the fact that entry is restricted gives those producers a more advantageous position than if there were more producers of that commodity. They are competitors in a monopolised trade and the extent of the competition is bounded by the degree of monopoly.

There is a further point in the argument. The advantages to the producers of a restrictive agreement or of a restricted entry to the trade are not to be found only in the trade under consideration. Resources which do not find employment in the restricted trade are driven to seek employment in other trades. Therefore, returns are forced down in those industries. There is an expansion in the unrestricted trades and a greater output. To carry off the increased output with the same demand the selling price has to be lower. Producers and wage-earners receive less remuneration compared with the restricted trades. People in the restricted trades reap a double advantage. Not only are their returns higher than they would be, but the commodities which these producers,

[1] Adam Smith, *The Wealth of Nations*, Chapter X.

as consumers, purchase from the over-developed trades are cheaper in price.

In the restricted trades there is the double gain; wages and returns to capital are higher and the cost of commodities bought from other industries is lower, whereas in the unrestricted trades not only are wages and returns lower but the wages and returns do not go so far in purchasing the output of the restricted trades.

If, for example, a monopolised coal industry is able to pay wages which are higher than they would be without monopoly, wage earners in that industry have the comparative advantage of the higher wages. But they have the additional comparative advantage that the wages of other workers have a reduced spending power owing to the higher price of coal. If also wages in some other occupation such as agriculture are forced down, agricultural workers have a reduced spending power, and at the same time they are confronted with increased fuel costs.

Public utilities

There is one group of industries where the phenomenon of monopoly is very evident, and one in which, in all countries, governments have controlled prices in various ways. Although not capable of an exact definition this group is usually referred to as public utilities, and comprises such industries as gas, water, telephones, and electricity supply. The characteristic of these industries is that the product is distributed from a central plant to the premises of an individual consumer by means of lines, pipes, mains etc. They are what is known as octopoid industries, having the characteristics of the tentacles of an octopus. They are usually subject to "increasing returns," i.e. that an increase of output usually leads to a lowering of the average cost of production. This is brought about by the fact that technical considerations are such that a larger plant is more economical than a small one. Furthermore, once the lines, pipes, etc., are laid it is possible to supply the individual consumer with more units of the commodity at a cheaper price. Once the consumer is connected to the mains, although the initial cost may be heavy, it costs little more to provide the consumer with a large output than with a small one. (This is provided that the existing installation is sufficient to carry an increased load.)

Once a telephone is installed in a house the cost of operation varies little with the number of calls which are made in a day; but if the number of calls increases so much that additional lines have to be run there will be an increase in the cost. Although here the cost of the additional lines will probably be less than the cost of the original lines as some of the equipment, such as telegraph poles, will have been already provided.

Industries of this nature are either established as monopolies or they rapidly become monopolies. In the early days of gas supply in this country there were often a number of competing gas companies supplying the same district, but after an era of fierce competition brought about by the supply characteristics of the industry, the companies came to an agreement among themselves to keep to separate areas and not to poach on each other's territories. Parliament recognised the logic of the position and granted statutory monopolies to the companies, subject to control by parliament. The effect of parliamentary control will be discussed in Chapter V.

Public utility industries have another important characteristic which depends on the peculiar circumstances of the fixity of plant and the fixity of the consumer. They are able to charge different prices to different consumers. They are able to "discriminate" between customers. In a perfect market a seller must charge the same price to all consumers. If A were charged more than B, A could obtain his supplies by arranging for B to purchase them on his behalf. But a "service" is provided to one individual, and generally cannot be transferred to another. If A is charged more for his gas than his neighbour, B, he may arrange for B to cook his dinner for him, but the possibilities of such transference are limited between classes of the community.

This characteristic of discriminating monopoly charging is not limited to the industries mentioned above; it is to be found in canals, railways, and urban passenger transport, and is a field in which governments have exercised their rights to control prices. The feature of monopoly, coupled with the possibility of discriminating between different consumers, has given rise to many interesting government problems, with many different solutions in different countries.

CHAPTER IV

CONTROL OF PRICES

THE economic system since the Industrial Revolution has been a planned economy. The plan was not at the centre but at the circumference; it was not based on a centralised direction but on a multitude of individual decisions. With certain exceptions it was based on the effective consumer demand. The criterion of the system was to supply those goods and services which were demanded by consumers.

The growth of industry

The remarkable growth of industry and trade, first in Britain, and then later throughout the world, was the result of throwing off the medieval shackles on trade and the gearing of the system to a price economy. The judgment on any particular part of the system was given by the price of the product, the price which satisfied consumers' demands, and the price which was sufficient to cover the costs of producing the goods and services required.

Goods were produced to satisfy a want. The fact that certain goods were wanted by individuals made it to someone's interest to supply those goods. Under free enterprise anyone who thought that he could supply the demands of the market produced the commodities he thought best. If he were successful he made a profit; if he did not produce the commodities that the public wanted, at the price that they were prepared to pay, he was unable to sell at a price which covered his costs, and he made a loss.

Production not only took place to satisfy a demand. It took place in anticipation of demand. An entrepreneur would produce a new commodity in the anticipation that when he put that commodity on the market people would buy it at such a price that would cover his costs. If his expectations proved correct the receipts from the sale of his product covered his expenses, which were often incurred a long time in advance of receipts, then he likewise made a profit, by correctly foreseeing the conditions of the market in the future. If his expectations proved incorrect,

and his receipts were insufficient to cover costs, then the loss fell upon himself and upon the people he had induced to follow his lead.

It is often forgotten when talking of the profits made by innovators under free enterprise that it was often only they themselves who believed in the possibility of success at the time. When the Duke of Bridgewater ran out of money in constructing his canal from Worsley to Manchester, the canal which was to halve the price of coal in the city, he was unable to find any local support and had to go to London to borrow the necessary funds.

The profits made by the successful are remembered. The losses made by the unsuccessful, by those who guessed wrongly, are forgotten.

Once the possibilities of new inventions and discoveries are realised, and it is found that there is a demand for them, the system of free enterprise leads other people to venture their money in the supply of the products.

The vast changes since the Industrial Revolution took place in a regime of a price economy. The present system which has come down to us is a price economy modified by government enterprise and government control.

Criticism of goods produced

The system has its critics. One of the principal charges made against the system of free enterprise acting in a price system is that it produces the wrong types of goods. The critic points with scorn to the fact that under "present system" vast resources of the country are devoted to, say, the production of a super-cinema, while few resources are devoted to, say, the building of churches. This is no criticism of "the system"; it is a criticism of the tastes of the public.

Super-cinemas are provided because a large proportion of the population obtain enjoyment, solace or forgetfulness, from their use. Taking people as they are, goods are provided which satisfy their wants, and it is no criticism of the system to deplore the tastes of the inhabitants of a particular country or of a particular period in history. If the system were differently organised, if a benevolent dictator gave the people what *they* wanted, super-cinemas would still be built. Economic study is concerned with people as they are and "is concentrated upon the world known

in experience, and in nowise extends to the commercial doings of a community of angels."[1]

Under a system of free enterprise goods are produced in the proportions in which people are willing and able to pay for them. If goods and services are produced which no one wants, sellers are unable to market them, and the sellers go out of that particular business. The price paid represents the cost to the buyer, and the choice between alternative products offered for his use. In other words, the system is democratic, each person "votes" for what he wants with what money he is able and willing to spend upon the commodity desired.

Inequality of wealth

A further criticism of the system is that the choice offered to the consumer depends on his wealth. Each "votes" for what he wants by offering what he has, but voting is not equal. Wealth is unevenly distributed. The rich have more votes than the poor. While this is important, and gives rise to government intervention to alter the relative positions of the rich and the poor, and will be the subject of later study, there are reasons for ignoring inequality at this stage of our inquiry.

Firstly, inequality of wealth is not a feature of the free price system. Great inequalities, probably greater than at the present time, took place under the Feudal System and are evident under the present system in Russia. (Which, of course, makes use of the price mechanism within a framework of strong government control.) It has been stated, for example, that the comparative difference in pay between a general and a private in the American, British, and Russian armies is about the same, although the absolute amounts are different in the three countries.

Secondly, to discuss the effects of an equalitarian distribution of wealth would take us too far afield from our main purpose. While it would, or might, raise the real incomes of the poor in the short period, there are important considerations to be taken into account regarding the incentive to produce, and its effect upon the national dividend.[2]

While governments are interested in the control of wages

[1] Pigou, *Economics of Welfare*, p. 6

[2] On the whole matter, *see* Pigou, *op. cit.*, Part IV, Chapters VII–XIII.

through Trade Boards, minimum wage legislation, etc., no government is suggesting more than an increase in the income of the poorer, and a diminution by taxation in the incomes of the richer, sections of the community. Even the first post-war government, for example, does not apparently believe in equality of incomes between Cabinet Ministers, members of Public Boards, ordinary wage-earners, and old people living on the proceeds of investments in British railways.

While it is true that inequality of purchasing power means that different consumers are able to exercise different force upon the market, there is no reason to believe that the abolition of the price system would bring equality of wealth. Neither does government price regulation necessarily add to the incomes of the poor; it often causes the reverse process.

Thirdly, even if wealth were evenly distributed, the free price system would still serve a useful function in the market, because different people have different tastes. Among people of the same income there is a wide difference in the things which they want from life. It is a mistake to think that all wage-earners, for example, have the same demands. "Jack Spratt could eat no fat and his wife could eat no lean" has a wide economic significance. Some people are smokers and drinkers, some are non-smokers and drinkers, some are smokers and teetotallers, some are both non-smokers and teetotallers; some are meat eaters, some are vegetarians. The price system measures the rate of exchange of different commodities and allows each person to satisfy his own tastes by exercising his choice of the commodities offered for sale.

An interesting article on the "Economic Organisation of a P.O.W. Camp" by R. A. Radford[1] brings out this point very clearly. The author shows that where "incomes" were equal (P.O.W. rations and Red Cross parcels) trade and exchange took place by a natural development due to the fact that all men are not equal in their demands for different commodities. Money was of no account but the cigarette soon became the means of exchange and the natural standard of value. It is quite clear that the system of exchange led each person to acquire those goods he wanted most intensely in exchange for the goods he valued least, by the medium of the cigarette money.

[1] *Economica*, November, 1945.

"Prices" were expressed in terms of cigarettes and they found their natural level at which demand and supply were equal without any outside intervention or regulation.

The profit motive

The system of private enterprise is also attacked because it is based on the profit motive. It is "morally wrong" that production should be carried on with a view to profit; that certain individuals make a profit out of other people's necessities. "Production should be for use and not for profit" is one way of expressing the idea.

All economic activity under any form of organisation is to satisfy people's wants. The greater the want, the greater the need for production to satisfy that want. If production were not carried out to satisfy various wants, and if production were devoted to making things which people did not want, there would be economic waste of the country's resources. The resources could be better devoted to other uses where wants were being satisfied.

Under the competitive system how does the producer make a profit? Only by being able to sell the goods and services which people want sufficiently to pay his price, and at the same time by producing those commodities at less cost than his receipts. The difference is his profit. The more he satisfies the wants of his various customers, the better his chance of a profit. If he produces the wrong commodities, or produces them at a price greater than people are prepared to pay for them, then he makes no profit but a loss and goes out of business—to make room for someone else who can satisfy the wants of the consumers. The entrepreneur is backing his own judgment with his own money; and he will succeed or fail in proportion as he performs the services required of him by the community.

The word profit is used in an ambiguous sense. In theoretical economics profit is a rather nebulous affair, tending to disappear altogether under conditions of equilibrium, and the profit of the business man consists of his payment for working in his business and providing the capital, etc.

No other man is expected to work for nothing. If we use the word profit not in its purely economic sense, but in the looser

way of general discussion and of the income-tax laws, "profit" is merely the personal return to the producer of a particular commodity or service. If people were not hungry, the services of the farmer would be no longer required; he makes a "profit," or earns his living, out of other people's necessities. The wage-earner, the coal miner, earns a living because people are cold; the doctor relies on human illness to provide him with the means of buying food from the farmer and coal from the miner.

In all walks of life the greater the satisfaction of other people's wants the greater the return or the profit. There is no moral difference in this connection between the business man who earns a profit out of producing something which people require, and his employee who earns a living at the same process. The only difference is that the employee expects his remuneration whether the goods satisfy people's wants or not; the entrepreneur *must* satisfy demand or he will have no return.

Free enterprise and the public

The system of free enterprise, or the system of the classical economists, therefore produces those commodities which the community wants. The general interest is served by each producing at the market price. "By pursuing his own interest he frequently promotes that of society more effectually than when he intends to promote it," and again, "he intends only his own gain and he is led by an invisible hand to promote an end which was no part of his original intention."[1] The classical position was that the advantage of society was *generally* promoted by each producer pursuing his own interest in a free price system.

It must be clearly understood that the classical or the free market price system did not go farther than this. It did not advocate completely uncontrolled economic activities, "the law of the jungle" as it is sometimes called. The free price system was assumed to be working in a milieu of the laws of the country; and in any case the theory as stated was that the pursuit of private interest through the price system *frequently* or *generally* promoted the general interest. It was not claimed that there was never any

[1] Adam Smith, *The Wealth of Nations*, Book IV, Chapter II.

reason for government intervention. Laissez-faire, to its advocates, did not mean economic nihilism.[1]

Adam Smith himself laid down some of the spheres of public enterprise and of government intervention, especially in his often quoted dictum that "defence is of more importance than opulence." In our own day Professor Pigou in *The Economics of Welfare* has analysed the sphere in which the pursuit of private enterprise does not enrich the national dividend. The obvious case is that of monopoly. The self-interest of the monopolist is generally to promote a high price of the commodity which he is selling; the general interest is in a low price and an abundant supply. Public utility industries are another very obvious sphere of public concern and of government intervention. Where the owner of a site in a residential district erects a factory thereon and so destroys local amenities, the pursuit of his own interest is not the pursuit of the general interest. Cases are numerous and must not be ignored, but they must be argued on their own merits.

It must not, of course, be assumed because there is a theoretical or a practical case for government price intervention, that that intervention will necessarily produce the best results. Governments are composed of fallible men. Although an excellent case may be made out in a particular circumstance for intervention by an all-wise, honest, and beneficent government, the actual intervention of the government of the day might lead to results which are even less desirable than the circumstances which it is proposed to improve. The remedy under ordinary human intervention may be worse than the disease. "The world is a hell on earth because men try to make it a heaven," and the world is often a poorer place precisely because men try to make it richer. The history of the world gives no ground for the belief that the actions of governments, in economic as in other matters, will invariably be for the best.

Price control motives—

The principal reasons for government control of prices appear to be the following:

[1] Cf. in this connection J S. Mill, that private enterprise should be the general rule, with Mr. Herbert Morrison, that the proper division was 80 per cent private enterprise and 20 per cent public enterprise There is no fundamental difference in the positions, it is purely a question of emphasis, and perhaps of percentages. *See also* Chapter XIV.

(*a*) *To protect the sellers of the commodity.* Where the government feels that it has a duty to support the sellers of a particular commodity it may interfere with the market mechanism in a number of ways with this object in view. Some of the principal examples have been the governments of agricultural countries, which have attempted to increase the price of the commodity sold on international markets; such crops as coffee in Brazil, sugar in a large number of countries, wheat in the principal wheat-exporting countries, come readily to mind. Where the "commodity" is labour, legislation on wages and hours of work is part of the same analytical problem. The legislation is designed to secure a higher price for the sale of the "commodity."

(*b*) *To protect the buyers of the commodity.* The opposite objective is at work here. The government is still concerned with the price, but it believes that the price is too high rather than too low. By a series of devices it tries to bring about a low price. The principal examples occur in the case of complete or partial monopoly, where the seller is in an advantageous position and is able to exact tribute from the buyer. The government, stepping in as a referee, may be able to force a different price on the market. The policy of "trust busting" in the United States, i.e. breaking up the various monopolistic trusts which had gained control of the market in many commodities; the control of railways and public utilities in all countries; and the fixing of maximum prices for different commodities on the market are devices with this general objective.

(*c*) *To fix a "just" price.* Closely allied to the above is the idea, not only of protecting the sellers as sellers, but of fixing a price which conforms to some idea of social justice. The methods may be the same, but the underlying assumptions are different. The medieval laws regarding the payment of interest on borrowed money (the usury laws) had more to them than fixing a price. There was also the idea of some abstract justice, or even the religious idea of what was due to a man, and what was due from a man. Similar considerations apply to the setting up of rent tribunals. Although their primary purpose is to protect tenants, they may have the function where necessary of increasing rents. The rent fixed is supposed to have some basis of social justice.

(*d*) *To improve the market mechanism.* Interference with the

prices of commodities may take place not because prices are considered too high or too low, but because the government is not satisfied with the methods of dealing with the commodities. Considerable dissatisfaction has been expressed by different governments with the working of the primary produce exchanges, such as wheat, cotton, and the metal market. In particular, the trading in "futures" (the buying and the selling of commodities in the future instead of at the immediate moment) has come in for special criticism. Prices of primary commodities are liable to considerable fluctuations, and the blame for these fluctuations has often been placed on the method of dealing with the commodity. Trading in "futures" involves some speculation. Interference may take place because it is believed that the speculation causes a "spread" of prices, i.e. that the difference between the price received from the consumer and the price paid to the producer is increased by the profits of the speculators. Government intervention may have the object of narrowing the gap which is believed to exist.

(*e*) *To protect certain classes of the community*. Both (*a*) and (*b*) involve the protection of certain classes either of buyers or sellers, but there may be the further object of protecting certain people for other reasons. The common agricultural protection of many European countries has often had as the objective other than purely economic considerations. The belief that country-bred people make better soldiers than town-bred has led to the encouragement of agriculture for military reasons. The Navigation Acts in this country were designed partly to breed a race of seamen for naval defence.

The lowering of prices to the poor, whether they are considered as producers or consumers, is to protect them from the consequences of their poverty and to put them in a better position than they would be under the ordinary market mechanism.

Closely allied to this consideration is the policy of redistributing the wealth of the country. Price control may have as its object the lowering of the share of the national dividend which accrues to the rich and the increasing of the share which accrues to the poor; and one method of doing this is by altering the prices of the commodities which are purchased by the two classes.

(*f*) *To alter the commodity on the market*. The price mechanism

may be used to control the physical quantity of the commodity produced and consumed. For various reasons it may be desired to increase or to decrease the amount of the commodity available. Taxes on alcoholic drinks raise revenue, but they also discourage consumption. An interesting example of this occurs where a government taxes home-produced beer to discourage consumption and at the same time subsidises foreign tea or coffee so as to encourage consumption of those drinks. A government which had a different opinion of the harmful nature of the two types of drink could use its price control to bring about the contrary effect. When tea was first introduced into this country it was known as the deleterious product of China! A theory that charabancs are rather vulgar and that rail travel is more respectable may cause a government to limit the one to encourage the other.

(g) *To reward political supporters*. Where a government draws its main support from certain classes of the community and is indifferent to the welfare of other sections the weapon of price control may be used to lower prices to consumers who are supporters of the government. Or it may raise the prices of the goods sold by people who are supporters of that particular government. One of the economic causes of the American Civil War was the tariff on manufactured goods levied in the interests of the Northern manufacturers. This tariff increased prices to the Southern agriculturalists with the consequence that they wished to separate and to form their own Confederate government. The Prussian government during the nineteenth century protected corn-growing because the Junker landowner was the principal support of the State. Other instances will probably occur to mind.

It is not to be supposed that the above are hard-and-fast divisions. The motives for price control may be mixed and the governments may institute control for a variety of purposes. The announced intentions may conceal a real intention. Often the real intention may not even be conscious in the minds of the legislators. Agricultural protection may have economic, military, and political considerations all mixed up, consciously or unconsciously. The protection of the consumers of certain products may be done with the idea of protecting these consumers as a class and with that of redistributing the wealth of the community. Part of the difficulty of judging the success of a particular policy

is to know what were the real objectives of that policy, and to what extent these objectives have been realised.

—and methods

The main methods of controlling the price of a commodity, or indirectly doing the same thing, are the following:[1]

(*a*) *Maximum prices*. One of the common methods is to fix a legal maximum price which may not be exceeded. An order is made that such a price is the maximum, and sellers are not permitted to charge a higher price. This is usually accompanied by penal clauses as to what will happen to the seller if he infringes the maximum price. An indirect way of attaining the same object is to fix maximum earnings which may be made from the sale of the commodity, such as the fixing of maximum dividends of companies supplying the commodity. The result is that if earnings exceed what is laid down by law the price is to be reduced. Maximum price regulations are one of the commonest price-fixing mechanisms to be employed by governments at all times from the Usury laws in the Middle Ages to the present day price control of a large and increasing number of commodities.

(*b*) *Minimum prices*. Where the object is protection of the sellers of the product a minimum price at which the commodity is to be sold may be imposed. This particularly applies where the "commodity" is labour. Wage regulation means that while buyers of labour must pay a certain minimum price it also means that no one may sell his labour at less than this price. Even if the seller is willing to work for less he is prevented from doing so, although the penal clauses usually attach to the buyer.

(*c*) *Taxation*. While the primary purpose of taxation is to provide a revenue for the State to cover expenditure, the method of taxation is used to further certain ends which the State, in the person of the particular rulers in power at the moment, considers to be desirable. The general effect of a tax is to raise the price and thus to limit the demand for a commodity. So that in addition to the revenue effect there is the effect of controlling the amount of the commodity which will be consumed and therefore the amount which will be produced. Where a government believes that it has

[1] Sometimes the sequence is reversed, price control is an indirect method of doing something else.

the total monopoly or even the partial monopoly of a commodity (not necessarily that the commodity is produced by the government itself, but that it is produced in that particular country) a tax on the export of the commodity to other countries may be imposed. The reason is either that the government is sharing in the proceeds of the monopoly or that it is trying to create and to profit by the monopoly conditions.

Primarily, the method of taxation is to use the price and market mechanism through its control on prices, instead of through other and more direct controls on quantities.

(*d*) *Subsidies and bounties*. The revenue of a State may be used not only for the ordinary expenditure but to make payments to particular industries or classes in the form of subsidies on the commodities that they are producing or consuming. The method has the aim of encouraging the development of certain industries by making them more profitable or of increasing the consumption of certain commodities among classes of the population by making the commodity cheaper. Again, the ordinary market mechanism is used to further a different end.

The quota, the fixed quantity which may be produced or which may be imported, is a direct method of regulating the supplies coming on to the market. Although the method is direct and does not use the price mechanism, the resultant alteration in the supplies has its effect on the price and so on the demand.

(*e*) *Control of supplies or sales*. One of the recent developments in the theory of control has been where the government has directly influenced price by buying or selling the commodity itself. Instead of controlling the price which private buyers or sellers may use the government steps in and buys or sells the commodity at its own price. The government, instead of being a controller of the price system, enters the market as a middleman and performs all the normal trading functions. It is needless to add that when the government enters into trade it rarely allows any rival to operate in the same market; in other words it buys or sells in bulk, i.e. in all the commodity on the market. It is a middleman with a monopoly.

In the treatment to be followed, it will be found that just as the objectives of policy may be confused, so may the methods be compounded of different ways of dealing with the matter in hand.

CHAPTER V

PUBLIC UTILITIES

THE protection of the consumers in what are known as the public utility industries is a legitimate field for government intervention. These industries have a natural tendency to become monopolies, so the State must see that the consumer is protected. The State has adopted different methods of control in the past hundred years. Some of them will be examined here.

Gas supply

The manufacture and supply of town gas as a public utility service began in 1810 when the first Gas Company was formed. This company obtained a Royal Charter in 1812 and became the Chartered Gas Company. By 1829 there were two hundred different gas works in the country.

In the early days of supply gas was regarded as a highly speculative business. There were people who regarded those undertaking the supply of gas as lunatics. Towns were plastered with notices warning the public against the ridiculous suggestion of supplying inflammable air to private houses. Gas companies were regarded more as public nuisances than as public utilities. No company was granted a territorial monopoly of supply. The companies were limited neither in their charges nor in the profits that they could make.

More than one company supplied gas in the same street. The roads were constantly torn up to connect new customers to the mains. It is even on record that some companies were not averse to connecting their own customers to the mains of rival companies. This competition of many companies in the same areas did not prove profitable to the companies nor entirely satisfactory to the consumers. Rival companies began to delimit areas of supply and to come to agreements among themselves not to compete with each other.

It is often stated that the natural tendency of competition is to develop into monopoly. While this is not true in general

commercial enterprises owing to the possibility of potential competition, it is probably true in the case of the public utility group of industries. It certainly was true with the early gas companies. Parliament was forced to intervene. The government recognised the arrangements that had been made by the companies and in return for recognising the monopolies that the companies had set up parliament imposed obligations. Companies were placed under an obligation to supply gas and maximum dividends were laid down.

Imposing a maximum dividend on the companies did not prove to be a satisfactory solution. Parliament was naturally anxious to protect the public by limiting the profits of the companies. But low profits to the supplier do not ensure low prices to the consumer. If the company is able to earn the maximum rate there is no incentive to improve efficiency. Companies could evade the provisions of the Acts by issuing bonus shares.

The sliding scale

There consequently developed a movement for an improved method of control. Dividends were to be dependent on the price of gas sold. If a company succeeded in reducing the price of gas to the consumer it was to be permitted to pay a higher dividend to its shareholders. In 1875 the Board of Trade was of the opinion that the sliding scale presented a better method of securing due care and economy in management than the fixing of maximum dividends. The Board of Trade *in that year* stated that it was doubtful whether any government department or any official commissioners, however zealous and competent, could succeed in dictating to a trading company the terms of manufacture.

The sliding scale system was adopted by many companies. At that time it proved to be a method of control that avoided detailed regulation and offered an incentive to the companies to reduce the price of gas.

While it was an excellent method of regulation under static conditions, the sliding scale method has grave disadvantages when there are considerable changes in prices. The rise in costs in the First World War caused the companies to increase their charges. The increase in charges automatically reduced the rate of dividend payable and there was a considerable fall in the value

of gas shares. In 1918 the previous law was amended and companies were permitted to pay three-quarters of the standard or the pre-war dividend, whichever was the lower.

The Gas Regulation Act of 1920 placed the sale of gas on a calorific basis and made provision for increasing the maximum and standard prices of gas where increases in costs were beyond the control of the undertakings. This Act also introduced the idea of the Basic Price method of regulation. Where the actual selling price of gas falls below the Basic Price the difference is shared between the shareholders and the consumers. Under the profit-sharing schemes which were a feature of British gas companies the employees also had an interest in the efficiency of their company.

Local authorities

Gas supply has also been undertaken by local authorities. In some cases local authorities have undertaken the supply of gas on their own initiative and in other cases they have acquired the undertakings that were previously started by companies. In the period from 1844 to 1867 thirteen undertakings were acquired by Corporations. The movement gained impetus and sixty-eight companies were acquired between 1869 and 1878. After this period the municipalising movement received a sudden check. The development of electric lighting caused a fall in the price of gas shares and local authorities did not wish to become burdened with undertakings that were feared to be obsolescent.

At a later date when it was seen that electricity would not completely replace the gas industry further undertakings were acquired by local authorities.

In general it may be said that the regulation of the gas industry has been wisely and competently administered. The State has recognised the difficulty of the problem and has not attempted too much detailed regulation. Local authority and company undertakings have learnt much from each other.

But even in this country regulation has had some unfortunate effects. In the early days gas was used for lighting only. It was not until the electricity industry came into being that the gas industry turned to other uses of gas on a large scale. The electricity industry has made much use of different methods of charging to develop

other than the purely lighting load. The gas industry has been handicapped in devising fresh tariffs by the operation of the maximum price regulations. Relating the dividend to the maximum price charged has prevented many companies from introducing two-part tariffs. Under a two-part tariff the consumer of a small quantity of gas is paying a high average price for the gas he consumes. This proved a difficulty to the undertakings that before the war were endeavouring to promote the sale of gas by offering more attractive methods of charging.

The difficulty is that the regulations are devised to suit the circumstances of the time. It is almost impossible for parliament to forecast future developments.

Electricity supply

The early history of the supply of electricity is very different from that of gas supply. The latter grew up in an age when private enterprise was supreme. By the time that the supply of electricity became a practical proposition ideas had changed.

Almost from the first the production of electricity was severely controlled. Eventual public ownership was envisaged. By the Acts of 1882 and 1888 the franchises granted to companies had a limited period to run. The undertakings could be acquired by the local authorities after a certain number of years. The first Act limited the period of operation to seven years. This was later extended to twenty-one and ultimately to forty-two years.

Parliament believed that electricity would replace gas and feared the development of monopoly. But in its attempts to control a monopoly that had not yet come into being it successfully prevented the growth of the industry. It was much too quick with repressive legislation. The result was to prevent many companies from undertaking the supply of electricity. Few people would engage in a new and risky enterprise in the knowledge that if the enterprise were unsuccessful their money would be lost and if the enterprise were successful it would be taken from them by compulsion.

Even when the period of the franchise was extended to forty-two years the policy was mistaken. Towards the end of the franchise the owners would be more concerned with the price

they would get for their undertaking than they would be concerned with the future development of supply.

The undertakings that were established were all small and generally restricted in area to the confines of a local authority boundary. Electricity was supplied by direct current and was extremely costly to transport over long distances. Hence parliament envisaged a future industry of small-scale generating stations supplying a purely local need. The development of alternating current was not foreseen. Alternating current is comparatively cheap to transport and is the basis of the economical linking up of large power stations through the "Grid" system.

Later Acts allowed the development of power companies whose function was to generate electricity in bulk and transmit it to the place of use. But the damage had been done. The industry was saddled with a large number of small undertakings under different ownerships. Many of these proved to be uneconomic under the new conditions of supply. It proved extremely difficult to bring about amalgamations to promote efficiency. Both small companies with their limited franchises and local authorities with their small undertakings were jealous of their rights and privileges.

It is not proposed to enter into the history of the large numbers of committees of inquiry into the electricity industry nor of the many Acts of Parliament that attempted to reform the conditions of supply. It is sufficient to state here that electrical development in this country has been hampered by the early restrictive legislation. It must also be remembered that the electricity industry in Britain has had to face the competition of a well-established gas industry.

The organisation of the electricity industry prior to nationalisation has excited much adverse comment. But the multiplicity of small undertakings supplying limited areas has not been due to the perversity of the companies or the local authorities. The organisation has been due to the special legislation of the industry. The industry has expanded in spite of, and not because of, detailed government regulation.

Competition between gas and electricity

In one respect the task of parliament in regulating these industries has been rendered easier. Gas was first regulated

because it developed into a monopoly. Electricity was regulated because it was believed that it would drive out the gas industry and become a monopoly in its turn. The belief proved to be unfounded. Sales of gas increased greatly after the establishment of the electricity industry. Competition has proved of greater protection to the consumer than has the regulation of either industry.

Neither gas nor electricity is restricted to its original purposes. Both have developed other outlets for the utilisation of their products. The two industries are strongly competitive for many purposes. Neither can afford to allow the other to be first with some new development. Before the war there was intense competition in the development of water-heating apparatus and refrigerators. Consumers were offered new and attractive methods of charging. Many of the statutory maximum prices became completely inoperative because the undertakings were selling well below the maximum permitted price. It was competition and development and not government regulation that brought down the prices to the consumers.

Since the war the electricity industry has been criticised because its prices are too low. To develop the consumption of electricity the industry devised the two-part tariff by which the consumer pays a fixed charge irrespective of consumption. This fixed charge is a contribution towards the overhead costs of the undertaking. All electricity used is charged at a low rate. The consumer who makes extensive use of electricity benefits by obtaining a low average price for the quantity used.

Owing to the post-war shortage of generating equipment electricity undertakings are unable to supply more current. But their methods of charging encourage greater consumption. The position is made worse because after the war resources were used to manufacture consumers' electrical apparatus instead of making generating equipment. In spite of the obligation to offer a supply of electricity undertakings are forced to resort to what is known as "load-shedding."

Forms of ownership

Competition in this country takes on other aspects. Both gas and electricity are supplied by companies and local authori-

ties. These industries are suitable for operation by local authorities and many of the largest suppliers of electricity are municipalities. In some cases the local authority owns the gas and the electricity stations. In other cases the local authority owns the electricity station while gas is supplied by a company. There has been a keen rivalry between the two methods of operation. Managers of company and of local authority undertakings have both been anxious to prove that their own form of operation is the better. We may say that the business efficiency of the company has reacted on the local authority, while the public spirit of the latter has influenced the company.

The country has gained by not having a uniform system of ownership. The administration of the two industries has not become stereotyped. Competition has been too keen for lethargy. Parliament in recent years has had little cause for interference because of the great developments in the two industries. When allowance is made for the differences in the areas supplied by the two forms of ownership there is little to choose between the operating results achieved. Costs and charges depend more on the economic conditions of supply than on the form of ownership.

The problem of the correct method of regulating a public utility that has a tendency to become a local monopoly is admittedly difficult. There are advantages and disadvantages to be found in different methods. But the system evolved before the war in this country was a compromise solution which avoided many of the difficulties.

For this reason the present "nationalisation" of gas and electricity is to be regretted. There is no necessity to be doctrinaire in this matter and advocate that all schemes of nationalisation are unjustified. All such proposals should be examined on their merits.

If the sole supplier of lighting and power were the gas undertaking there would be a very strong case for public ownership. A such supplier would be in a strong monopolist position, and the self-interest of the monopolist would conflict with the interests of the remainder of the community. The State would be bound to intervene to protect the public from exploitation. Nationalisation of the industry could be one solution among a number of others. A stronger case could probably be made out

for administration to be in the hands of the local authorities, as they are more likely to appreciate local needs than would a centralised management. Or undertakings could be in the hands of companies that were controlled by parliament. The method of control could take the form of relating the dividends of the companies to the prices charged by them.

Similarly, if the sole supplier of lighting and power were the electricity undertaking there would be a strong case for nationalisation. The case would be stronger for electricity than for gas. In the present state of technique electricity can be transmitted at a cheaper cost than gas over large areas. Although there is a "gas grid" it is less developed than the electricity "grid." The central generation of electricity offers greater economies than the central production of gas.

The case for nationalisation of either industry taken separately is strong. The case is much weakened when both are considered together. Through their separate authorities gas and electricity now come under the Ministry of Fuel. The diversity of ownership has been swept away. Monopoly has been reintroduced into two industries that were largely competitive. It is contended that nationalisation raises more problems than it solves. If either of the industries develops at the expense of the other will the Ministry stand by and allow the weaker to go under? Or will it put obstacles in the way of development to prevent either of its adopted children committing fratricide? Complaints were made in the past that where the local authority owned both undertakings it tended to hold back the development of electricity so as not to destroy the value of the investment that it had made in its gas plant. At least this was a common complaint of electrical engineers, who may be forgiven a certain amount of professional bias in this matter!

New inventions

There is a more serious objection to the present policy. The State now has a vested interest in preserving the status quo. Vested interests are bad for people, including those in governments. Where a government is interested in preserving an existing situation it has many weapons at its disposal to prevent the growth of rivals.

Under existing techniques with our present knowledge the centralisation of power supply is an economic proposition. It is cheaper to provide the power in one large station and to distribute this power by means of mains and pipelines than it is for each consumer to provide his own power. But it must not be forgotten that gas and electricity are very young industries. There was a time when each factory had its own source of power in the steam engine or the water-wheel. Houses in isolated districts at the present day draw their supplies of electricity from their own wind-operated dynamos.

It is *technically* possible for gas to be distributed in cylinders. Generally it is more economic for it to be distributed through the mains. It is technically possible to store electricity in batteries and to transport the batteries from place to place. It is generally more economic to produce electricity at the time of use and distribute it through the public supply system. The question at issue is not what is scientifically possible, but what is the best method of supplying the consumer.

If there were some new invention that reduced greatly the cost of storage of electricity our existing system might be rendered obsolete. If a cheaper method of distributing gas in containers could be devised there might be no need for the present system. We can no more foresee what new inventions will be made in power supply than the early gas engineers could foresee the development of electricity.

If some future inventor goes before the Capital Issues Committee for permission to raise capital to develop a source of power that will supersede gas and electricity he is likely to encounter a cool reception. His proposal would not be "in the public interest." As the State undertakings are to obtain capital at specially low rates the supply of capital to develop new inventions will be still more restricted.

Railways

In all countries railways have presented governments with difficult problems to solve. The fixity of the lines and the heavy costs of construction make for a natural tendency towards monopoly. This monopoly has been further strengthened by the powers conferred on the railway undertakings by parliament.

Railways were started privately and had to meet much opposition before they could become established. There were the vested interests of the canal companies and the road coaching proprietors standing in the way. Fortunately these vested interests were in private hands and were eventually overcome. If the State had built and owned the canals the path of the railway projector might have been even more difficult.

Each railway had its own private Act, so that parliament was enabled to exercise a certain amount of control. The great difficulty facing the legislature was the realisation that the new form of transport had a tendency towards becoming a monopoly and yet it was much more efficient than any former method of moving goods or passengers. Any form of control to protect the public had to be careful not to impair the efficiency of the railways.

Further difficulties were caused because each railway company owed its existence to a private Act that defined the special powers and obligations of each company. This added to the confusion of the railway legislation. Parliament had to feel its way gradually in face of this new problem.

In 1844 it was enacted that there could be a revision of the charges of the companies if the rate of dividend exceeded 10 per cent. This was not acted on in any way, for which one very good reason was that the rates of dividends on railway shares have very seldom reached 10 per cent. Railways have not proved to be singularly profitable to the investors. Costs of construction in this country have been very high, and the receipts from the traffic have been insufficient to pay large sums for the use of capital. (On the other hand, many of the early canal companies paid high rates of dividends and were very profitable investments. In many cases it was the high profits of the canals that induced people to invest in railway construction.)

By fixing an upper limit to the dividends parliament sought to protect the public against high charges. It went further and the same Act introduced the "Parliamentary" train. This was a daily passenger train that, if required, stopped at every station on the line and conveyed third-class passengers at a penny a mile. Later travellers who complain that train journeys are slow

because of the frequent stops often fail to realise that the many stops are imposed on the companies by parliament.

In 1873 there was set up the Railway and Canal Commission to control the railways. One of the chief complaints previously made by traders was that the companies often gave "undue preferences" to certain favoured consignors of goods. These complaints now ceased. A second result was that there were no longer any acquisitions of the canals by the railway companies. The canals, after the introduction of railway traffic, had carried more goods than ever before, but as the railways became established the canals gradually declined. Some had been bought out by the railway companies, but as these purchases ceased the position was stabilised. There was little chance of a unified canal system acting as a competitor to the railways.

Maximum charges

Direct control of the rates charged was instituted with the Railway and Canal Act of 1888. Every railway company had to submit to the Board of Trade a revised classification of goods and a revised schedule of maximum charges. This entailed a complete re-classification of the goods carried, as each company had had its own method of classifying its traffic. The suggested maximum rates for the traffic were then discussed with the various traders concerned, and a long process of bargaining ensued by which many traders were able to get reductions in the proposed maximum rates to be charged for their goods.

While railway companies themselves had introduced the idea of different rates for different types of traffic the Act of 1888 gave parliamentary support to this principle of charging, and it has been a matter of considerable controversy ever since. Rates were based on the cost of handling the goods, and also on the principle of "charging what the traffic will bear." Goods of low value and large bulk obtained lower rates; goods of high value in small bulk paid higher freight rates, and helped to subsidise the bulk traffic. Railway writers have called this policy the principle of "tempering the wind to the shorn lamb," but either way of describing the policy brings out the fact that as monopolists railway companies were able to introduce differential methods of charging. They could discriminate between

classes of their customers. This policy was to have unfortunate results when the companies lost their monopoly.

The new rates became law in 1893. The companies raised all their rates to the maximum allowed by parliament. As they had lost revenue by the reductions that had been imposed on them, they wished to recover this loss by raising rates where they had previously charged below the new statutory maximum. This certainly appears to be reasonable, as parliament itself had sanctioned the higher rates.

In 1894, however, parliament passed a further Act, which stated that if the companies raised their rates above the level of 1892 they had to prove that the increase in rates was "reasonable," which was not defined. It was generally taken to mean that the companies had to prove that there was some increase in the cost of operation of the service. After fixing certain defined maximum rates parliament insisted that rates should remain as they were, except where they had been lowered!

Stabilised charges

The intention of parliament was to protect the public against high rates, but the results were quite different from those intended. "In the first place the railways were afraid to try experiments in lowering rates for fear they should not be able to raise them again without appeal to the Railway and Canal Commission. It therefore checked any downward tendency of rates. It has also been said that it discouraged economies, since that would tell against the railways if they wished to raise rates. It finally killed any competition in rates that might have developed. Companies were afraid to lower rates to fight each other for fear they might not be allowed to raise them again, and so nothing was left but competition in facilities. After 1894 competition in granting facilities increased, and a new era in English railway history was begun."[1]

This is one of the most important lessons to be learnt from a study of price control. As will be shown in Chapter VIII the fixing of maximum prices for commodities or services often causes the maximum to be taken as the normal price. Competition, instead of developing on a price basis, changes its form and

[1] Knowles, *The Industrial and Commercial Revolutions in Great Britain*, p. 281.

becomes based on the provision of facilities that may or may not be desired by the consumer.

A fierce competition developed in facilities offered to the public. Third-class coaches were improved and third-class travellers obtained a better service, such as faster trains and dining-cars. As the third-class passenger was obtaining a service that was nearly equivalent to that of a first-class passenger it meant that he got something better at the same price. But it may be questioned whether this was in the best interests of the poorer traveller. It may be that he would have preferred a less developed service at a lower cost. As it happened, he was forced to patronise the higher quality service with no reduction in fares.

The competition in facilities increased the operating costs of the railway companies and so prevented any lowering of rates through economies in working. This competition also increased the railway amalgamations that parliament had so strenuously tried to prevent. Faced with the rising costs of operating the service and the fixed maximum prices the only course open to the companies seemed to be that of amalgamation to reduce expenses.

The 1921 *Act*

Parliament eventually abandoned the attempt to preserve competition between one railway company and another and in the 1921 Act forced amalgamations on the companies. Of the 214 separate companies, 121 of them were combined into the four well-known large companies.

A new method of control was instituted. The Railway Rates Tribunal was established to fix appropriate charges. A Standard Revenue was allowed to be earned, provided that the railways worked with efficiency and economy. (No definition of efficiency was or could be provided by Act of Parliament.) The Standard Revenue was the revenue, with certain additions, that the companies had earned in 1913.

Once more the intentions of parliament were frustrated by the march of events. Railways were now regarded as public utilities. They were treated as monopolies, and therefore were controlled in their charges by the Tribunal. But the railways were not monopolies. The new groupings of the four main-line

companies followed the lines of densest traffic, so that a lively competition still existed on the routes serving the largest centres of population. On the long routes there was always the competition of the coastal steamer. Owing to the shape of the coastline the sea surrounding Great Britain has served the same function as the canal in Continental countries in acting as a competitor with the railways.

The motor vehicle

A new development had apparently been overlooked. While parliament in 1921 was passing the Act that was to give a monopoly to the railway companies a new competitor was arising. There was a great development in road transport following the application of the petrol engine to methods of warfare between 1914 and 1918. When the war was over there were large numbers of surplus vehicles sold by the government. A considerable number of soldiers had been trained to drive, and had acquired a new skill as compensation for the lost years. Many of these ex-Service men invested their gratuities in the surplus lorries and entered into business for the conveyance of passengers or goods.

Part of the traffic carried was new traffic that had never run before, but part of it was in direct competition with the railways. In this the new road operators were assisted by the railway method of charging "what the traffic will bear." While the road haulier could not compete with the railway in moving bulky commodities over long distances, he could compete successfully with the high-class traffic that paid the best rates. Because the rates were high the road operator could offer lower rates, and in the words of the railway companies he was able to "skim the cream of the traffic."

The native inventive genius provided a solution that had evaded parliament for nearly a century. Parliament had feared and attempted to control a railway monopoly. The monopoly was overcome by the progress of a new invention; always the danger facing any monopoly.

Ideas had, however, changed. Early railways had developed in spite of the vested interests of the canal owners and of the coaching proprietors. In the twentieth century railways were

vested interests of capital and labour well represented on both sides of the House of Commons. Road development was therefore stifled in the interests of protecting the existing suppliers of transport facilities. As will be seen in Chapter VII, both goods and passenger transport by road was severely limited.

Nationalisation

After a long endeavour to prevent the development of monopoly by statutory established railway companies, parliament in 1947 gave a partial monopoly of transport to a statutory established British Transport Commission. The danger in this policy is not that the Commission will fail to carry out its duties with care and efficiency, but that it will be in a strong position to curb progress brought about by competitive inventions.

Competition still exists. Sea transport remains a potential competitor with inland transport. But as the Commission may own all the docks used by the coastal vessels, the position of the latter may be endangered. Traders may still use their own vehicles to carry their own goods (the C licence holder), but in the present trend of thinking it is obvious that the licences will be granted only on the good behaviour of the traders, and they must not compete too successfully with the Commission.

Passengers, if they can afford it, may still provide their own means of transport. The private motorist, however, can be impeded by petrol rationing and forced to use public transport. This method of dealing with a competitor will be excused with the argument that petrol costs dollars, and the crudest mercantilist theories will be used to support a great vested interest.

The final objection is that nationalisation by itself solves no problems. It has been seen that parliament in the last hundred and twenty years has been faced with the problem of trying to control the charges of a monopoly supplier of transport services. To turn the problem over to a new body for solution is not to solve it. Parliament is evading the responsibility that is parliament's alone.

CHAPTER VI

PROTECTION OF THE SELLERS

SELLERS can generally be relied upon to attempt to protect their own position. The growth of monopoly, of trade associations, trusts, cartels, of "gentlemen's agreements," are all evidence of the efforts of sellers of a commodity to increase the price, or to prevent the fall in the price, of the commodity which they are selling.

But assuming that there is no legal barrier there is nothing to stop other sellers coming into the market and selling for what price they can get. Private monopolies can be broken and offer no permanency. Where sellers are numerous and difficult to combine they will be in the position of competing sellers and will have to accept the market price. Even where there is a "gentlemen's agreement" not to cut prices the organisation may break down because all the sellers do not behave like "gentlemen."

If because conditions are such that owing to forces beyond the control of the individual seller the price is forced below what is considered to be a remunerative or a "proper" price for the commodity, and if the sellers of the commodity constitute an important part of the population of the country, either by way of numbers or voting power or wealth, the government of the particular country may be, and often is, drawn into protecting the sellers.

The necessary conditions will frequently occur in agriculture, especially with the basic cereal crops. Owing to the conditions of production, whereby it is impossible to foresee the total amount of the crop, which depends on climatic conditions as much as upon the acreage under cultivation, regulation of the supply is extremely difficult. Further, the demand for the commodity is apt to be relatively fixed (the demand is "inelastic"), and this is especially true in the case of foodstuffs. As a consequence of a variable supply and a steady demand changes are shown in a fluctuation in the price. Times of heavy crops are

apt to be times of low incomes to farmers. Therefore where cereal crops form a large proportion of the national production of a country the temptation "to do something for the farmers" has been one which few governments have been able to resist. This is particularly true where the crops are exported to other countries.

Wheat

The increase in production in the main exporting countries, Australia, Argentina, Canada and the U.S.A., by the end of the 1920s caused a general fall in prices which did not lead to an increase in consumption. In Canada the farmers' associations themselves attempted to regulate the market by withholding supplies. The Canadian Co-operative Wheat Producers, Ltd. (the Wheat Pool) was formed in 1924 as the selling agent for the farmers who were members of the Pools in the three prairie provinces, with the declared object of reducing speculation and improving marketing methods. In 1928 there developed a surplus which the Pools attempted to handle by withholding supplies. This carry-over handicapped the selling of the 1929 crop and as the Pools were operating on borrowed money and the price fell they were soon in financial difficulty.

The governments of the three prairie provinces therefore guaranteed the Pools' borrowings from the banks and in 1930 gave the banks a guarantee against loss in respect of the 1929 crop and the carry-over of the 1928 crop.

Further difficulties developed in the 1930–1 crop. As the price continued to fall and the guarantee of the provincial governments did not extend to the 1930 crop the Dominion government was called upon for assistance, and it in its turn guaranteed the bank advances.

The Central Selling Agency set up by the government in 1930 attempted stabilisation measures by holding unusually large quantities of grain out of the market, and by buying "futures" to hold up the price of grain in the autumn when the crops were being harvested. The Agency continued to hold stocks until the Canadian Wheat Board was set up in 1935 with the financial support of the Dominion government. The operation of the Board in disposing of the huge accumulated surplus

resulted in a loss of over $11,800,000 on the 1935 crop, and of $49,000 on the 1936 crop.

"As to the effect of price stabilisation measures on overseas markets, I must say that the unanimous opinion obtained from millers, merchants and traders was unfavourable to the system. They all expressed the belief that its results were injurious to the sale of Canadian wheat in the market. The market dislikes selling monopolies or near-monopolies, the retention of wheat from sale, or anything which looks like an attempt to secure prices out of line with those paid currently to other sellers. They blamed the stabilisation measures for all these things. The trouble begins when the overseas consumer is asked, in turn, to pay these relatively high prices for Canadian wheat.[1]

"It was this withholding of wheat from the market, giving rise to a fear among buyers of an attempt to extort unreasonable prices, that led to the criticism overseas, and caused consumers to turn elsewhere for their requirements."[2]

The Pools were supported as a new method of marketing wheat because it was believed that they would secure higher prices. As one report put the matter, "It is perfectly obvious that under a system of national control, where only one seller exists, and buyers are numerous, the advantage is with the seller." That report, as the Turgeon Commission pointed out, overlooked something which was equally obvious, that there would not be one seller only, but many: sellers of Argentine wheat, of Australian wheat, of American wheat, etc., all competitors.[3]

Farmers in the short run gained by the indirect subsidy, which was the heavy losses incurred by the government, the difference in the price paid to the farmers and that realised from the sellers being the government loss, so in that sense we may say that protection to the seller was obtained at the cost of the general taxpayer. But in the long run buyers were offended and turned to other sources of supply so that future prices were consequently lowered.

In the United States the policy of guaranteed prices by the

[1] *Dominion of Canada Report of the Royal Grain Inquiry Commission* (The Turgeon Report), 1938, p. 99.
[2] Ibid., p. 100.
[3] Ibid., p. 83.

Federal Farm Board and the withholding of stocks was also applied. This proved to be fantastically costly and was later abandoned. The guaranteeing of prices, of course, led to land being kept under wheat when the world position required that less land be devoted to wheat production. So the Federal government later changed its policy to that of acreage reduction, and in 1938 even granted subsidies for transferring land to other crops. While the policy proved extremely costly to the American taxpayer it did not have the bad effects of the Canadian experiments, because the proportion of American wheat which enters international trade is comparatively small, as most of the production is required for the home market.

Similar schemes were operated by the other exporting countries, and the general subsidising of wheat production in the principal countries led to the accumulation of gigantic stocks which further depressed the price of wheat and the profits of wheat farming.

An attempt to regulate the matter internationally by the fixing of export quotas among the principal exporting countries after 1933 resulted in one exporting country, the Argentine, and nearly all importing countries, breaking their pledges![1]

The report of the National Federation of Corn Trade Associations prepared in 1944 for the Ministry of Food stated with reference to this problem that the Canadian Pool was the biggest experiment in producer marketing that has ever been seen. The Pool started its operations under a most favourable set of circumstances; nevertheless they were disastrous, and largely contributed to the first building up of unwanted stocks. The control attempts of the exporting countries led to many European countries protecting the home market by tariffs and subsidies and import quotas, which further increased the production of wheat at a time when conditions required a reduction of acreage. Production was so increased that many countries which were normally importers became exporters of wheat.

This policy of the European countries was no more successful in protecting the producers in those countries. The standard of living of the peasants in protected countries, such as Germany, France and Italy, was substantially below that of

[1] *Commodity Control*, P. L. Yates, p. 39.

the unprotected peasants in Holland and Belgium or of farmers in Britain. In the latter countries the cheap grains were used to develop livestock production and to give a more diversified agriculture.[1]

Coffee

The coffee crop is one of the classical examples of government interference with the forces of the market. The vast bulk of the world's coffee supply is obtained from Brazil, and it is to that country we turn for further examples of attempts to protect the seller of an agricultural crop in the world market.

In 1906 there was a bumper crop, and the State of Sao Paulo, one of the principal coffee areas in Brazil, decided to enter the market to buy part of the crop and to hold it off the market to dispose the surplus when conditions were more favourable. The operation was financed by means of foreign loans, and the policy proved to be successful. By 1914 all surplus stocks had been liquidated and the loans repaid. Part of the success was attributable to the conditions of world trade. As there was a rising demand the crop could be unloaded without spoiling the market. Also new planting had been prevented since 1904.

The same policy was pursued in 1917, and again proved to be very successful. A frost in 1918 ruined the trees, cutting down production, and the existing output was disposed of easily, due to the post-war boom in consumption in the years 1919–20.

The success of the previous schemes from the sellers' point of view led the government to introduce a permanent control scheme in 1922. Regulating warehouses were built to hold stocks and money was advanced on coffee delivered to store. When high prices were ruling during the period 1924–6 advances were made to planters on the same basis.

When the market broke in 1929 enormous stocks were held and no more money could be borrowed. Prices were halved owing to the great over-production brought about by the system of internal payments.

The policy of burning surplus stocks was initiated in 1931, and from then on about one-third of the total annual crop was

[1] Ibid., p. 27.

burned. An export tax was levied to finance this scheme. Eventually the whole scheme broke down. Other producers had expanded production under the high price policy of Brazil, and that country lost the coffee monopoly. Consumers turned to other types and acquired for those types a taste which was difficult to alter.

The disastrous failure of the attempt to keep up the price in the interest of the producers was partly due to the confidence inspired by the success of the earlier and less ambitious schemes. If these had been unsuccessful there would not have grown up the belief that the government could permanently assist the producers by price control and regulation. The position was outflanked by the two great enemies of monopoly, a change in ideas of the consumer and the encouragement given to other producers to develop their supplies. If the government had burnt its fingers in the first place it would have been unnecessary to have burnt so much coffee at a later date.

Rubber

One of the main forces at work in promoting restriction schemes in the natural rubber-growing industry was the feeling of producers that they were in an especially strong monopolistic position. Rubber forms a small part only of the cost of the final product in which rubber is used. An increase in the price of rubber has little proportionate effect on the total cost of a motor-car, therefore it was an industry in which producers could obtain higher prices without those prices exercising an appreciable effect on the price of the final demand.

In 1922 the British government, at the request of the British Rubber Growers' Association, put the Stevenson Restriction Scheme into operation and within a few months the selling price of rubber doubled. While sellers were happy under these circumstances, there were loud protests from consumers in both Britain and America. By 1925 prices were high, stocks were low, and there was a strong anti-British feeling in other parts of the world.

The high prices led to the encouragement of supplies from the Dutch native producers, and the British monopoly, which had never been complete, was broken by the growth of other

competitors. Between 1921 and 1927 Britain's share of the world market declined from 61 per cent to 53 per cent, while the Dutch share increased from 26 per cent to 40 per cent. In 1928 the Scheme was completely abandoned.

Mr. Yates's judgment on the Scheme was that it was short-sighted and defeated its own object. The restriction of output raised prices and therefore brought in fresh producers, so that what monopoly position did exist, and this was exaggerated, was destroyed; consumers were antagonised and the original position of the restricting producers was weakened.[1]

The failure of limited restriction led to consultations with the Dutch with the object of making the restriction of rubber more watertight. Eventually in 1934 all the producing countries, with the exception of Liberia and South America, entered into an international scheme for regulating the supply of rubber to the market.

The basis of the scheme was the prevention of new planting with certain exceptions, and a quarterly export quota allowed to each producing country. The distribution of the quota was fixed locally within each country, and the quota covered the permissible amount of rubber which could be placed on the market. While this arrangement was still a producers' monopoly the working of it was more flexible than the Stevenson Scheme, as quantities could be adjusted according to the state of trade.

It must also be remembered that it was instituted in a period of improving world trade, and the demand for rubber is largely governed by upward and downward movements of the trade cycle. It was therefore applied at a period when, from the producers' point of view, it was less necessary. The attempt was made to cover the costs of the producers on European estates as though these costs themselves were fixed. But as Mr. P. T. Bauer has pointed out, when prices were falling costs of production were also falling because of the incentive to reduce costs and to increase efficiency.[2] The keeping up of prices in the interests of the producers kept up costs. When prices fell costs

[1] P. L. Yates, *op. cit.*, p. 119–20.

[2] "Rubber Production Costs during the Great Depression," *Economic Journal*, Dec., 1943.

were reduced, so that the industry could operate on a lower cost basis and so encourage consumption.

The antagonising of the consumers, especially the American users, was a contributory cause of the growth of the synthetic rubber industry. Although for some purposes synthetic rubber has properties which are not possessed by natural rubber, the growth of the synthetic industry was largely encouraged by the fear of the consumers of being squeezed by an international cartel, so that the position of the grower was made worse. "No tears need be shed over the final dissolution of the International Rubber Regulation Committee . . . and there should be no return to the pre-war restriction policies."[1]

There is one further point. When the "protection of the seller," i.e. of the producer, is under consideration it is necessary to see who is the seller. In the case of rubber production comes from two sources, the European estate and the native producer on a smallholding. The restriction schemes which were put into operation did not seem to err on the side of excessive consideration for the small native producer in Malaya. If the operation of the schemes had been in the hands of the large estates one might be excused for believing that the interests of the native producer would not receive excessive consideration. But the administration of the restriction schemes in the East was in the hands of civil servants, "yet the smallholders could hardly have been treated worse if the whole machinery had been operated by estate representatives. Indeed, the 'order' which replaced 'chaotic competition' was rather like the law of the jungle. One is forcibly reminded of a sentence of Alfred Marshall in his *Principles*:

" 'In many cases the "regulation of competition" is a misleading term, that veils the formation of a privileged class of producers, who often use their combined force to frustrate the attempts of an able man to rise from a lower class to their own.' The experience of rubber regulation also emphasises that when government intervenes in economic affairs the lack of knowledge of economics on the part of civil servants is likely to prove a serious drawback."[2]

[1] The *Economist*, 12/5/44.
[2] "The working of rubber regulation," P. T. Bauer, *Econ. Journal*, Sept. 1946.

Mr. Bauer is of the opinion that the smallholdings are probably the most efficient producers, so that protection of the rubber growers was protection not of the most efficient. It was an attempt to stabilise a position which was therefore inherently unstable, and while in the interests of the most powerful producers it was not in the interests, short period or long, of the producers who were less able to take care of themselves.

Tin

After the First World War the governments of Malaya and the Dutch East Indies instituted a scheme to withhold tin from the market as the price had fallen heavily owing to the post-war slump. Stocks were gradually liquidated by 1925, and the price rose rapidly in the years following. Again it was a case where the demand conditions were such as to absorb the annual output plus the accumulated stocks, and the price rise was due to the increase in demand. The scheme had been successful from the start because it had been instituted on a rising market . . . the conditions under which the producer requires no protection.

The high prices encouraged improved methods of mining in existing areas and the extension of tin mining in new areas, generally those in which costs of production were high, with the result that by 1929 output had outpaced consumption and the price of tin collapsed.

Various attempts to introduce control were made, principally by the high cost producers, but these were opposed by the low cost producers who were able to cover their costs in spite of the heavy fall in price. At the end of the depression, when prices would be expected to recover, a control scheme was set in being. An International Committee was set up in 1931 under the auspices of the governments of the principal producers, Malaya, Bolivia, the D.E.I. and Nigeria, with the result that export quotas were allocated on the basis of the amounts exported in 1929, a year of depression.

The scheme went further than the fixing of quotas to limit supplies. An International Tin Pool was formed to acquire tin and keep it off the market. Tin could be sold by the Pool when market prices reached a certain level. This scheme from the producers' point of view was not unsuccessful. By 1935, when

the general world position and trade had improved, the stock carry-over had been disposed of at a profit. But the greater the appearance of success, the greater was the opposition from the consuming countries, again principally the United States.

As with other such schemes the higher prices encouraged tin mining in different countries. Although customers were annoyed they were unable to produce synthetic tin as rubber consumers produced synthetic rubber, which would add to their annoyance. While the long-term price was raised as a consequence of the quota scheme (and general trade recovery) the chief bugbear of metal mining was not removed; fluctuations in demand were reflected in fluctuations in the output of the individual mines. In wheat production variations in conditions are reflected in prices; in mining variations are reflected in output; and the scheme did little to alter this "natural" state of affairs. The keeping in production of the high cost producers was not in the long run in the interests of the low cost producers or of the consumers.

Copper

Tin and rubber are examples of commodities which are largely produced within the British Empire and sold in the United States. It is not, however, to be supposed that it is only the British and other governments in these schemes which have pursued this sort of policy and which have antagonised their principal customers. Regulation of price or production has a different "look" depending on whether the onlooker is in a producing or a consuming country. The United States is a very large producer of copper, and producers there were able to form a monopoly and to raise prices considerably. This resulted in the development of other areas, and the high prices ruling made it easy for the Rhodesian producers to obtain ample capital for development with up-to-date equipment and so to become the lowest cost producers in the world.[1] South American production was also developed with American capital to break the monopoly within the United States.

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[1] P. L. Yates, *op. cit.*

No attempt has been made to deal exhaustively with the various schemes of commodity regulation or with what other schemes or methods could have been operated. These have attracted much attention in the past, in particular in the studies of Mr. J. W. F. Rowe in *Markets and Men* and of Mr. P. L. Yates in *Commodity Control*. These works should be consulted by anyone wishing to acquire details of these and other schemes not mentioned in this text.

Intervention on behalf of the producer of a commodity, interference with the normal market mechanism, has had some temporary success. When governments have interfered in a period when prices are rising or after a depression in trade, the policies have shown much apparent success. Even so the normal market mechanism would have given producers better prices without intervention. But the protection of the sellers has necessitated higher prices to buyers. Many schemes have collapsed because consumers have turned to other sources of supply or to other products, or because the high prices have called into being additional production, so that the last state is worse than the first. Even from the narrow point of view of the selfish interests of the sellers and ignoring the economic loss incurred by the buyers where output is restricted, it could not be said that these policies have met with an unqualified success; when the interests of consumers are taken into account the result is even less praiseworthy. The interests of the consumers have generally been ignored because in the majority of the schemes of the national or international control of prices the producing and the consuming countries have been different. The attitude adopted is coloured by the fact that the consumers are only foreigners anyway. This attitude would have met with little praise from a Liberal or even a Socialist during the previous century.

CHAPTER VII

HOME PRODUCERS

THE last chapter concluded with the observation that protection of the seller in a number of schemes was assisted by the fact that the buyers were foreigners, and therefore a government which was operating them did not have to worry unduly about the reactions of the consumers. While this is hardly ethically sound it has a certain specious political attraction. The fact that the world was made poorer by restriction of trade, and that this would rebound eventually on the heads of the people they were attempting to protect, was a long-term view which few governments seem to be capable of appreciating.

Where, however, the producers and consumers are in the same country, different considerations apply. If prices are raised to benefit sellers, buyers may become aware of this, and the latter may exert pressure on the government for a reversal of the policy. This is why many of the devices to raise price claim to have some other object, such as to reduce "the adverse balance of payments"; or to bring "order" into an industry; or to prevent the foreigner from undercutting the home producer (i.e. selling to the domestic consumer at a lower price than the domestic producer is trying to exact). If the seller is assisted the buyer in the same country has to be bought off or misled in some way.

One method of assisting sellers without raising prices to the consumer is by the granting of a subsidy to a particular industry. The consumer pays this subsidy indirectly as a taxpayer, but not as a consumer of the product. He can make no direct comparison of the rise in price caused by this policy as the figures are disguised in the financial budget. These figures are more or less inaccessible to the man in the street. Furthermore consumers, who are generally producers of other commodities, can be kept complacent by the hope that they, too, may share in the distribution of the subsidy from the national funds.

A further method is to assist sellers to form a monopolised

selling body, and even to invest this monopoly with all the force of law, which will prevent any individual producer from underselling his competitors. The two methods are often worked together in practice.

A straight tariff on the import of the commodity which is sold is direct assistance to the home producer. Because of the Free Trade tradition of this country consumers are generally alive to the fact that an import duty has some tendency towards increasing the price which they are to pay for that commodity, and this method has to be used with caution. An extremely useful way out of this difficulty is by the device of the quota, which restricts the importing of a commodity which competes with a home product. This reduces the supply on the market and therefore raises the price to the benefit of the home producer. However, the government can truthfully say that they are not imposing a tax on what the people eat or wear or otherwise enjoy.

The Agricultural Marketing Acts

The Agricultural Marketing Acts combine several of these devices in varying proportions. The original Act of 1931 was an "enabling" Act. It did not force reorganisation on the producers. It enabled producers, or a majority of the producers, to devise a scheme for the marketing of the product if they so wished. As it stood they did not wish; farmers were reluctant to forgo their independence and to put themselves in the hands of some selling authority. But they were quite understandably willing to forgo the import of commodities which competed with them for the consumers' favour. The farmers were therefore bought over to the idea of Marketing Boards by the imposition of quota schemes regulating imports.[1]

The Boards are to be distinguished from voluntary co-operative marketing organisations set up by producers such as the Canadian Wheat Pools; once set up they have wide statutory powers; they may impose levies on all producers, whether these are in favour of the schemes or not; they may buy and sell agricultural requisites; they may constitute themselves into trading bodies and compel all producers to sell only to them-

[1] L. Robbins, *The Economic Basis of Class Conflict*, p. 142.

selves; or may issue regulations regarding the price or sale or quantity of the product; and they have the power to impose very severe penalties upon any producer who deals outside the scheme; fines up to £200 plus half the price at which the goods were sold may be imposed upon the recalcitrant producer.[1]

Hops

The *Hop Market Scheme* was the first to be set up under the Act and it exhibits some peculiar features. The Board sells all hops, arranging the price with the Brewers' Society—which is a case of bilateral monopoly. But the interesting feature about this Board is not how the price is determined—hops are only a small part of the final product which is principally a vehicle for the collection of taxation—but how the producers are "protected."

Production is fixed on a basis of quotas. These quotas depend on the acreage under hops when the quotas were allocated. Those who happened to be growing hops in the year in which the quotas were granted are in the scheme and are "protected." Before this, when prices were ruling low, some hop growers had gone into fruit production; when hop prices were high they returned to hop production. It is precisely this changing of production to suit the conditions of the market which is in the public interest. If hop prices are low and land is more productive if turned over to fruit or vegetables then it is in the general interest that the fruit or vegetables should be produced, as the community evidently sets a greater value on that use of the land. If hops rise in price then the community requires that land be replanted with the hops which are now more valued. The grower who followed this line of conduct, however, was penalised. Never could he turn to hop production, no matter how much the community required that he do so; he was not a grower in the basic year. He was not a protected producer.

The interesting fact is that economic truth will out. The "right" to grow hops was a privilege which could be bought and sold, so that protected producers could go out of the industry by selling their "right." New producers, therefore, were charged an admission fee or the rent of land was increased, so that the

[1] L. Robbins, *op. cit.*, p. 147.

benefits soon became capitalised into increased costs for the new producers. Instead of being a protection to a current industry the scheme amounted to a capital payment to a group of people taken at random. "I have seen an advertisement of a farm with fourteen acres of hop gardens in which the Basic Hops Quota was separately valued at £2,500. On what principle does the State hand out this largesse? it is interesting to note how speedily such benefits are transmuted into rents or premiums which discount all the gains to the succeeding owner or tenant."[1]

Potatoes

The *Potato Marketing Board* is another producers' Board set up under the Marketing Acts. Existing producers were protected in two ways by acreage quotas and by selling restrictions. The basic acreage allowed for potato growing was that put down to potato growing in 1933, or the average of the years 1931–3. Any producer who wished to extend his potato acreage so as to produce more food in the country was allowed to do so provided that he paid a fine of £5 per acre for all excess acreage. Unlike the hop scheme new entrants were allowed, provided that they paid this £5 per acre fine.

If in spite of these deterrents production of potatoes did increase, the Board had other means of keeping the increased quantity away from the consumers and so keeping up the price. The Board could lay down the size of potatoes which were allowed to be marketed. The "riddle" regulations were altered to suit market conditions. When there was a good crop small potatoes were kept off the market to avoid the price being lowered.

How this worked in practice can be seen from the report by the Food Council for the year 1937. "The 1937 crop in Great Britain has been estimated to be about 6½ per cent in excess of the 1936 crop. . . . The Board consequently decided to impose more stringent riddle regulations, to rescind their resolution permitting the sale of 'seconds' (small potatoes), and to take steps to buy and store potatoes where necessary to maintain prices. . . . We would observe that consumers are

[1] G. L. Schwartz, *Planning and Economic Privilege* The Manchester School. Jan., 1946.

entitled to receive some compensation in seasons of larger production for the higher prices which necessarily rule when the crop is abnormally low."[1]

In the year 1938 not only were drastic riddle regulations introduced, but the sale of potatoes weighing more than 1 pound was for a time forbidden. In the same year there were complaints from the National Federation of Fish Fryers of inability to obtain supplies of potatoes, and some friers preferred to close their shops rather than pay the high prices demanded.[2]

Pigs

The basis of the *Pig Marketing Scheme* was the import quota fixing a total supply at about 10 million hundredweight, and quotas were allocated to foreign countries according to home production. The intention of the import restrictions was to reduce seasonal and cyclical fluctuations of prices and to eliminate the difference in prices between British and Danish bacon.

But while home prices rose to a certain extent, due to the normal pig cycle movement in 1936, Danish prices rose higher. The housewife preferred the Danish, which had a reputation for consistent quality, and was prepared to pay more for it. In 1934 we paid more to Denmark for considerably less bacon than in 1933. The Danes were in favour of our quota scheme to protect British farmers![3]

The bacon quota forced the British consumer to subsidise the home bacon producer, the Danish and other producers, and the overseas growers of feeding stuffs which the farmers imported to feed the pigs. The effects of the subsidy granted were that for every £1 of subsidy saved by the taxpayer, about £3 would be paid by the consumer of bacon to the foreign producer in the form of unnecessarily enhanced prices.[4]

Even the administration of the subsidy has been called in question. "We have in previous reports protested against the allocation of pigs to curing factories by uniform quota, since it compels all factories alike to cure fewer pigs than they can

[1] *Report for* 1937, p. 20.
[2] *Report by the Food Council*, 1938, pp. 19–20.
[3] Astor and Rowntree, *British Agriculture*, p. 172.
[4] *Report by the Food Council*, 1938, p. 2.

efficiently handle. The result is that a well-placed and well-managed factory is not only unable to develop, but is even forced to refuse business in order to keep its less efficient competitors alive."[1]

Milk

The *Milk Marketing Board* is faced with complications which do not enter into the other Boards described above. Sellers of milk have two markets, the market for "liquid" milk and the market for manufactured milk, i.e. for butter, cheese, etc. Before 1914 there was no great difference in the price obtained in the two markets, but the world fall in prices of butter and cheese diminished the receipts of those farmers selling in the manufactured market, and the development of road transport brought the outlying farms into close contact with the liquid market, and so threatened the milk price.[2]

The Board is therefore a monopolist of milk sales and is able to exercise discriminating charges for its product according to the market in which the milk is sold. By keeping milk out of the liquid market it is able to preserve the price so that there is no danger of the consumer obtaining a supply of cheap milk. The balance is sold to manufacturers of milk products at a price which will enable them to compete with the price of imported milk products.

It is immaterial to the individual farmer whether his milk goes into the liquid or the manufactured market. The country is divided into a number of regions and the producers receive payment in the ratio of the total sales at the liquid and at the manufacturing price. The total receipts are pooled and divided, not in the proportion in which the individual supplies the liquid market but in that which the regional sales are divided. Nor is his all. The cost of production and the selling prospects vary from region to region, so the Pool price will depend upon the district in which the farmer lives. So that the farmers in an area which has a large proportion of low-priced manufacturing milk should not receive less than the others, a special levy on all liquid sales is imposed and paid into an inter-regional compensation fund.

[1] Ibid., p. 3.   [2] Astor and Rowntree, *op. cit.*, p. 196.

The effect was that the Eastern farmers paid the Western a tribute for not spoiling the milk market.[1]

Thus the increased supply of milk in Britain, instead of meaning an increased consumption at a lower price, has meant the growth of a subsidised dairy product industry. The domestic consumer is paying a high price for milk in order to develop the production of dearer cheese, etc., than could have been purchased from abroad.

It is no wonder that the Cutforth Commission recommended that price fixing and policy be no longer entrusted to the Milk Marketing Board, which is a powerful producers' monopoly.

The Report of the Food Council for 1937 pointed out that a higher proportion of milk was sold in the liquid market and: "We should have hoped that the increased proportion of milk sold for liquid consumption, resulting as it has done in increased pool prices to the producer, would have enabled the retail price of liquid to be reduced. We consequently regret that in fact consumers have to pay higher prices in 1937–8 than for many years past."[2]

Also, "We pointed out that in each year since the Scheme came into operation the quantity of milk sold for manufacture at uneconomic prices has been substantially larger than that necessary to safeguard the liquid supply, and that, had only the latter quantity been sold under the Scheme, it would have been possible for the same, or even a somewhat higher return per gallon to be made to producers and for the price payable by consumers to be reduced."[3] Further on great concern was expressed about the increased price of milk since the schemes came into operation.[4]

It is a further peculiarity of the scheme that the farmer who does his own selling (the "producer-retailer"), who is generally a man in a small way of business, has to pay a levy to the Board for marketing expenses! He is, of course, not paying for any services rendered because he does his own marketing, but he is paying a levy to people farther from the market to enable them to compete with him.

[1] Astor and Rowntree, *op. cit*, p. 200.
[2] *Report*, p 10. [3] Ibid., p. 12.
[4] Ibid., p. 15.

Sugar

The interference in the sugar market by different governments has been notorious. They have kept out cheap supplies of cane sugar to subsidise the growing of dear beet sugar at home. They have even granted export bounties to encourage production. Even Britain, one of the principal consuming countries, engaged in the same policy and developed an extensive and costly sugar beet industry in this country. The Greene report in 1935 was of the opinion that no beet sugar industry in the world had been brought into existence without artificial support.

Consumers in all countries were forced to pay directly excessive prices for sugar, or to pay indirectly in the form of taxation for sugar which could have been produced much cheaper abroad. When it is considered that much of the cheap sugar has been produced in the British West Indies and was one of our traditional and important trades, and that the British government had to come to the rescue of ruined planters, and was concerned with much labour unrest in those colonies, it is difficult to justify the expenditure of several millions per annum on beet sugar. This expenditure did not extend arable cultivation at home, it merely diverted land from non-subsidised to subsidised crops.

Transport

After the Great War the development of war-time transport and the training in the army of a large number of drivers led to a considerable extension of road transport facilities. Ex-service men with their gratuities were enabled to purchase a lorry and offer transport of goods at cheap rates. The consumer—that is the man who wanted goods moved, or the town wage-earner who wanted a cheap charabanc ride to the sea—benefited from the development of this new invention. Just as in the past the nineteenth-century consumer had benefited from the development of railway transport.

Part of the development was new transport as it was transport which had not moved at all until the provision of the new facilities at the new prices. But part was obtained at the expense of older methods of transport. In the nineteenth century, when the

railways proved themselves able to offer a better service than the canals and the horse-drawn coaches on the road, the former were allowed to develop to provide the public with the means of transport which they preferred. In the twentieth century, however, parliament interfered to protect the old against the competition of the new.

The Road Traffic Act, 1930, limited the development of road passenger transport. From that date there ceased the competition between different road operators in providing cheap fares. As a result the railway companies were enabled to acquire controlling interest in many road passenger undertakings, so that price competition was much reduced. The Road and Rail Act of 1933 applied the same principles to goods traffic, and the main weapon of restriction was that of the licence. The "C" licence-holder, the man who moved his own goods in his own vehicles, had a right to do so. The "A" licence-holder, the carrier of goods for hire or reward, had no right to be in business. He had to prove to the satisfaction of a tribunal that there was a need for his services. When he applied for permission to earn a living he could be opposed, and generally was opposed, by his competitors. In other words, people in the industry were placed by parliament in a position to limit entry to the trade, so as to keep up prices against the public.

While it was not impossible to obtain a licence, it was extremely difficult and expensive to do so. Thus a new invention which offered a possibility of striking developments in transport costs was hamstrung from the start because of the protection afforded to those already in the industry. If the same policy had been pursued when railways first threatened the existence of the coaching proprietors or of the canal owners, the great advance due to the invention of the railway would never have been made.

(It is necessary to point out that the railways had a case in this dispute. Railways were themselves strongly under the control of parliament because of the fact that when the various railway Acts were passed the companies had a virtual monopoly of transport. As monopolies they were therefore placed under various legal disabilities designed to protect the public against actual or possible extortion. But when railways were no longer monopolies owing to the growth of other means of transport parliament

continued to treat them as monopolies, and applied similar restrictive regulations to road transport. Either the railways had a monopoly, therefore road restriction was unnecessary, or the railways did not have a monopoly, so it was unnecessary to place them under the legal disabilities under which they undoubtedly did suffer in meeting a new competitor. As it was, the consumer obtained the worst of both possible worlds.) See Chapter V.

Coal

Similar restrictions were applied in the coal-mining industry by the Coal Mines Act of 1930. This was a government measure to reorganise the industry and to benefit the producer. It "enabled the industry to establish statutory minimum prices and to fix output quotas which tended to perpetuate the ground plan of the industry. The competition of fuel oil was deadened by taxation."[1] The equalisation of selling prices and the quota restrictions of output, besides adding to the cost of coal to the domestic and industrial user, enabled inefficient mines to remain in existence. The large and up-to-date mines could no longer undercut their selling prices. State aid to benefit sellers not only has injured buyers but it has preserved the industry in a state of inefficiency. This has reacted on the profits of the best firms in the industry and has induced the State to nationalise the industry to cure the very inefficiency which it fostered.

War-time arrangements

The various marketing devices referred to above were in operation prior to the war, and during the war they were suspended. As yet the pre-war methods of producer-controlled marketing of certain agricultural products have not been revived. This, however, does not render their study less important. On the contrary, it is by evaluating the results of this policy that we may avoid in the future any mistakes which were made in the past.

When war broke out the government undertook the control and the marketing of the primary foodstuffs which had been sold through the Marketing Boards or through normal commercial

[1] *Is British Industry Inefficient?* Professor John Jewkes. The Manchester School January, 1946.

channels. Some of the implications of the policy adopted are considered in the following chapter and need not detain us here. It is sufficient to say that while normal peace-time methods practised by private enterprise were considered to be ill-adapted to the requirements of a war economy, the *ad hoc* Marketing Boards established by the government were equally unsuitable for the purpose. (The Hops Marketing Board alone continued in operation.)

The Ministry of Agriculture was mainly concerned with control over the crops grown, whereas the newly established Ministry of Food was mainly concerned with the distribution of home-grown and imported food. Much of the latter Ministry's control was necessitated by the policy of subsidies to keep down the official cost of living index number.

Future policy

In December, 1946 the government appointed a Committee under the chairmanship of Lord Lucas "to review the working of the Agricultural Marketing Acts; to consider what modifications of the provisions of those Acts for the organisation of producers are desirable in the light of experience before 1939 and of the developments since then in government policy, as it affects food and agriculture; and to make recommendations." The Committee reported in September, 1947.[1]

A review article on the findings of the Committee was published in *Economica* in May, 1948. All readers of the report should make a close study of this article.[2]

The Committee in a very short review of the operation of the Acts made a number of criticisms of the way in which the Marketing Boards had operated, although as Mr. Bauer points out there were many important points which it did not discuss. The Committee accepts criticisms of the Boards in so far as it rejects a return to the pre-war policy of producer control of agricultural marketing (page 56). It equally rejects retaining on a permanent basis the present system of the Ministry of Food (page 57). It

[1] *Report of the Committee appointed to review the working of the Agricultural Marketing Act.* H.M.S O. 1947 (The "Lucas" Committee)

[2] "A Review of the Agricultural Marketing Schemes," P. T. Bauer, *Economica*, May, 1948.

therefore, not unnaturally in the present tendency of economic thinking, suggests some far-reaching proposals.

Commodity Commissions

The Committee recommends that for the major agricultural commodities the authority to be entrusted with the primary responsibility for marketing strategy should be an independent body which, "for want of a better name, we shall refer to as the 'Commodity Commission,' and which should be financed from public funds" (page 58).

As there is to be a Commission for each commodity or related group of commodities (page 58), the strain on the public funds is likely to be considerable. As it would be the duty of the Commodity Commissions "to ensure that the arrangements for the marketing of the produce shall be as efficient and economical as possible" it is difficult to accept the necessity of a subsidy from the general taxpayer. The purpose of the Commissions is to effect unspecified marketing economies. If these economies are realised they would provide a fund for the payment of the Commission. If there are no economies, why the Commissions?

The Committee recommends that the members of the Commissions should be appointed by the Agricultural Ministers and the Minister of Food and that "As expert, impartial, and authoritative bodies the Commissions will be well fitted to undertake major responsibilities in the practical application of the new policies for food and agriculture" (page 59).

It is one thing to recommend an industry to be efficient, it is quite another to have this efficiency realised in practice. Assuming that the recommendations of the Committee are at some future date passed into legislation this will require time. It is therefore unknown who will be the Ministers of Agriculture and the Minister of Food. Nor is it known who will be the members of the Commission appointed by these future Ministers. Certainly the members will be authoritative, the powers conferred on them will see to that. Possibly they will be impartial. But how can it be assumed that they will be expert and well fitted to undertake the great responsibilities of the work? It may be that after the Ministers had canvassed "the general fields of industry, commerce, finance, and public administration" (page 58) that the selected

well-fitted experts were unwilling to serve. They might prefer to remain in the field where the pasture was familiar. Or they might even be induced by other Ministers to serve on some of the many numerous Commissions established by various Acts of Parliament.

It is noteworthy that the Lucas Committee does not recommend a return to the free market as it existed before 1931 (page 53), but it implies that the free market has the merit of training men of suitable ability to carry out the policy of the Commodity Commissions.

. . . . .

"As is so frequently the case with proposals for the establishment of public corporations, extravagant claims are made on behalf of these as yet unconstituted bodies which could not decently be put forward on behalf of a government department or a private organisation."[1]

The Lucas Committee "in effect advocates statutory monopolies, though of independent membership, in the marketing of the great bulk, or the whole, of the British agricultural output. The grounds for this proposal and the functions and operation of the projected commissions are outlined in very vague and general terms only and no indication is given how these bodies are to secure substantial economies compared to the 'unco-ordinated mass of producers.' In particular the functions proposed for these commissions are liable to very varying interpretation. The experiments in the operation of 'organised marketing' before the war suggest only too plainly what practical results are likely to flow from such imprecise general aspirations."[2]

Producers' Marketing Boards

It must not be assumed that because the Lucas Committee has made some incomplete criticisms of the pre-war operation of the Marketing Boards and because they advocate the setting up of huge statutory monopolies that no place is to be left in the future for these Boards.

On the contrary, with all their faults they love them still. The Committee was much impressed with the change in attitude of the farmers. "It would appear that where formerly apathy, or even

[1] P .T .Bauer, *op. cit.*, p. 142. [2] Ibid p. 141.

hostility to the Acts existed, there is nowadays an eager desire not only to secure as soon as possible the full resumption of marketing schemes now in suspense or partial operation, but also to promote additional schemes" (page 63). As these Acts conferred immense monopoly powers on people in the industry the "eager desire" is quite understandable. The Committee welcomes "this *enlightened* attitude on the part of the agricultural community because we are convinced that the *disciplined* co-operation of producers in this field is vitally necessary for the success of the new agricultural policy" (my italics). The association of producers of a commodity into a monopoly to force up the price to the public has been an age-old idea but never before has it been referred to as an enlightened attitude.

There is also a grim ring to the suggestion of the disciplined co-operation of the producers. Elsewhere in the report (page 5) the Committee refers to the "ingrained individualism of the British farmer." Evidently he has to be coerced into these theoretical grandiose organisations. The monopoly Marketing Boards would have the function of negotiating contracts with the Monopoly Commodity Commissions.

The whole tenor of the report reflects the present day attitude that the setting up of a new form of organisation solves a particular business problem. It does nothing of the kind. It merely transfers the problem to another set of persons. These persons still have to effect the great economies which could not be found by people with a lifetime of experience in the trades concerned.

CHAPTER VIII

RETAIL PRICES

THE control of prices to the ultimate purchaser may be achieved either by controlling the price of manufacture or by controlling the price after manufacture as the goods pass through the various distributive outlets, or by a combination of both methods. It is useless, for example, to fix maximum prices of sale by manufacturers if selling prices to consumers are left free; consumers would still pay the price fixed by supply and demand for the commodity and the difference would be absorbed by the wholesaler and the retailer.

Profit margins

Control of retail price may be achieved either by fixing a maximum retail price for the commodity or by fixing the maximum spread which may be allowed between the buying and the selling price. The spread which occurs between the two prices is the retailer's or the wholesaler's "margin." Out of this margin, or his gross profit, he has to pay his costs for the work which he does. Price control may therefore be effected by controlling the margin of profit or by controlling the selling price and allowing the margin to take care of itself.

The margin varies from trade to trade. It represents to the consumer the cost of bringing to him the product which he buys.

A high margin does not necessarily mean a high profit for the distributor. A high margin of profit means a large gross profit per article, but net profit depends upon a number of other factors. Some commodities are more costly to sell than others. A jeweller has a large amount of capital tied up in stock which does not move quickly; a furniture retailer incurs considerable costs of storage and he must have a stock on exhibition so spread out that customers may see it; sellers of perishable commodities have to allow for the fact that all their stock will not normally be sold. Part will be lost, so the margin on sales has to cover losses on purchases which yield no return.

Retailing and wholesaling are service industries, distributors provide the goods plus the various services rendered by them to the purchaser. The holding of stocks until they are required necessitates expenditure on warehousing, on the capital tied up in goods, etc. Retailing may vary in service and in cost, from handing goods over the counter up to expensive wrapping, or even to actual delivery at the customer's door. It may include considerable credit terms of payment. In particular, the tendency which has been noticed in recent years for the consumers to buy in smaller quantities, but to buy more frequently, adds to the cost of retailing by adding to the number of retail transactions. The same tendency among the retailers to order in smaller quantities adds to the cost of transport, as the same volume of traffic travelling in a larger number of individual loads is more costly to handle than bulk traffic.

The cost of retailing

The rise in the cost of retailing which has been noticed in the present century may be due to an increase in the services which distribution offers, which is an increase in the "utility" of service rendered. The rise in cost may be due to a decrease in the efficiency of distribution. Instead of the housewife making and storing her own jam at the time of the fruit harvest as in Victorian days, she now buys jam when and as required from the grocer. There is therefore an apparent rise in the cost of distribution. What has happened is that the cost has been transferred from the housewife to a specialist so that the element of "waiting" and storage now appears as a retail cost. But there has been no increase in distribution as such, merely a transfer of costs between consumer and trader.

Again, comparisons are often made between the cost at the pithead with the cost of coal retail. This is comparing coal in different places at different times and in different quantities. The difference between the two costs is referred to as the cost of distribution, whereas in fact all costs are costs of transport. Man does not produce coal, economic "production" is the transport of coal from the place where Nature put it to the place where man requires to use it.

The retailer's net profit does not depend solely on the margin

of profit. It depends on his volume of trade or his turnover. A high gross profit margin does not mean a high level of net profit if the total trade is small. On the other hand, high profits may be made by handling a large volume of transactions at a low margin of profit. An increase in the margin with the volume of trade remaining the same will result in large profits. The larger profits will tend to draw other people into the business. This will reduce the average turnover of each establishment and so reduce the net profit. Retailers generally look to a larger margin in order to increase their incomes, but the result of an increased margin is often contrary to their expectations.

A fall in the margin will lower net receipts and profits. If the effect of this is to drive out the inefficient firms the remaining firms may well make the same profit. The customer will therefore obtain the same goods with a lower price spread, and the retailers existing in the trade will be as well off as before. However, the reduction in the number of retail outlets will throw part of the costs of the economies on the consumer, who will have fewer shops. The housewife, therefore, will have to travel further on the average to effect her purchases. It is difficult to draw up a balance between the disadvantages of a high margin of profit which adds to the number of shops and to the cost of the goods, and the disadvantages of a low margin of profit which reduces the cost of the goods in the shops, but adds on to the customer costs which do not enter into normal business calculations. Whether we can say that retailing is inefficient because of the price spread or that retailing is efficient because it provides a large number of selling points for the customer's convenience is a question upon which it is difficult to judge.

Related commodities

In many trades retailers are not selling a single commodity at a fixed margin of profit. It is quite common for the retailer to sell a number of related commodities at different margins, or even to sell a number of quite unrelated commodities from the same premises. While the average margin of profit on the total trade may be high, the margin on certain individual articles may be very low. At one time sugar has actually been sold at a loss because the customer for sugar is usually a customer for other

commodities which provide the profit margin out of which the retailer carries on his business. A low margin on butter may be compensated for by a high margin on jam because the two commodities provide the joint supply of butter and jam. Confectionery carries a higher margin than cigarettes, so to some extent the latter are marketed at a lower cost than they might otherwise be because part of the retailing costs are carried by a high margined commodity. (The high margin on confectionery accounts for the large number of retail outlets.)

A reduction of the margin on certain goods which are jointly sold with other goods at a lower margin quite easily might have the effect of increasing the margin required on the latter. If this happens the costs of distribution are not lowered but are spread differently over the range of commodities sold. It can be seen that price regulation may lead to some surprising results, or at least to results which were not intended.

The effect of the war

The great spate of price regulation was due to the outbreak of war. It was decided that as there would be an extreme shortage of certain goods prices would rise to the consumer to a degree which would not be countenanced by the government. This policy commanded general, but not universal, support. It is of course bound up with other questions of government control, such as the utility schemes, consumer rationing, allocations, etc. Instead of the adjustments required being obtained by the forces of the market through the mechanism of changes in price, the adjustments were brought about by physical means.

It is often stated that this was necessary because of the failure of the price system to bring about the quickly required adjustments from peace to war. It follows that it was a failure of free enterprise to effect a desired result. This is not so. The free price system is designed to produce the goods required by a large number of different consumers with their varying needs under normal conditions. The milieu of the proper acting of the government machine is assumed. The war changed all that. Questions of peace and war are not in modern times questions of private enterprise. Relations with foreign powers are the proper functions of government. This is admitted by all advocates of free enter-

prise. The outbreak of war is not a failure of private enterprise, it is a failure of government, and therefore the milieu in which free enterprise can work is radically altered.[1]

The objectives of a peace-time and of a war-time economy are entirely different. In the former they are to satisfy a demand for a variety of purposes, in the latter to satisfy the demand for the government to win the war as economically and as quickly as possible.

While mistakes may be made under any system of price regulation the mistakes made under the pressure of speed necessary in war-time will require a more charitable treatment than those made under pleasanter conditions. Granted the necessity of price control in war-time, the more important consideration is not that something be done well but that something be done quickly.

Cost-plus

The normal method was adopted of price control throughout the various channels of distribution and by the control of the price of the goods from the factory. Generally existing methods and existing firms were used to implement the policy of the government. The existing functions were still carried on and the post-war price control methods follow the same pattern.

One method adopted was that of allowing for the cost plus a certain margin of profit. This method has been much criticised.

"We are of the opinion that, in dealing with the manufacture of a commodity of common consumption and relatively low unit value, by far the most satisfactory method of securing economic prices is the exercise of free competition. . . . Most forms of price control have inherent disabilities, and in particular, cost plus net profit systems tend to place a premium upon inefficiency."[2] The arrangements made between the Boot and Shoe industry and the Board of Trade have been designed to minimise the disadvantages of the cost-plus method, which arrangements have been endorsed by the Working Party.[3]

And again, "In view of the widely held opinion that a cost-plus

[1] This is not to be taken as an argument that under the circumstances it was "wrong" to go to war in 1939.

[2] *Working Party Report on Boots and Shoes*, p. 26.

[3] Ibid., p. 27.

system has serious disadvantages we have given careful consideration to this feature of the utility clothing price control. While we recognise that cost-plus in addition to the detailed schedule of ceiling prices may offer an additional protection to the consumer, it is not an incentive to efficiency and often results in the incurring of unnecessary costs."[1] *The Working Party Report on Heavy Clothing* points out that "the ascertainment in advance of the exact cost of production is a matter of accounting impossibility,"[2] and that the disappearance of cost-plus would prepare the way for a smooth transition to conditions of free competition which at the appropriate time will best serve the interests of consumer and producers.[3]

The price fixing of non-standardised commodities leads to other complications. It is often impossible to define the "commodity" whose price is fixed and therefore to comply with orders issued by the government. The manufacturer may observe the price but vary the product. For example the *Working Party Report on Wool* observes that there has been some falling off in the quality of utility goods brought about by the inelasticity of the price ceilings and that it is false economy in labour to encourage the manufacture of goods of poor quality.[4]

In the wool trade at the moment the Board of Trade fixes maximum net profit margins for manufacturers, merchant converters, and gross margins for merchants or wholesalers and retailers. For utility goods the price at each stage must not exceed the "ceiling" prices fixed for each specification.[5]

The *Cotton Working Party Report* points out some of the complications which occur in that industry. "The experience of war price controls has shown how difficult it is to fix prices at which they ought to be with an adequate standard of efficiency . . . there has not yet been evolved a technique which solves satisfactorily the essential problem of how, in the absence of free competition, to settle the 'right price' to be paid for a particular commodity."[6]

In the Memorandum of Dissent some other aspects of price control are noted. "At the present time practically all the prices

[1] *Working Party Report on Heavy Clothing*, p 19.
[2] Ibid
[3] Ibid., p. 20.
[4] *Report*, p. 75
[5] Ibid., p. 94
[6] P. 154.

which a spinner or weaver (or merchant in the home but not in the export market) receives for his services have an official upper limit. The need for a firm grasp on domestic prices—as a part of an anti-inflationary policy—is indisputable. But the present arrangements mean that the prices paid to the spinner and weaver for those of their products which pass indirectly into the export trade are also fixed."[1] Prices to foreign countries are kept low in a seller's market, and the country is deprived of foreign exchange which is particularly necessary at the present time. Profits which could go into re-equipment for the future are not being made.

Channels of distribution

The use of the normal distributive machinery also raises other questions. The preservation of the *status quo ante bellum* especially where the channels are compulsorily fixed by the government precludes the possibility of improvements being made in the system of marketing goods. New "inventions" are just as important in wholesaling and retailing as in manufacture. Any rigidity imparted into the system will prevent improvements.

The problem is no new one. The question of the fixing of retail prices by manufacturers or groups of manufacturers (price maintenance) is outside the scope of this inquiry. It is a private matter and unless the government supports the manufacturers in their policy it is not a question of government price control. If, on the other hand, the government either fixes these prices, or delegates the power to fix prices to some other body, it cannot evade the responsibility.

Milk

The Report by the Food Council for 1937, in discussing the price of milk, reiterated the objections which they had expressed in earlier reports to the existing system of fixing minimum retail prices.[2] The Council preferred the recommendation of the Cutforth Commission that the wholesale price should be fixed by an independent body and that retail prices should be left free, or fixed by an independent body.[3] The minimum retail prices as fixed by the producers under the Milk Marketing Board are flat

[1] P. 230. [2] P. 13. [3] 1938 *Report*, p. 14.

rates with no regard to the services rendered by individual distributors. Where competition does exist, it can only be in rendering luxury services which increase the cost of distribution and are pleaded as justification for increased margins to distributors.[1]

According to the Chairman of the Milk Marketing Board the methods of war-time control lead to inefficiency. Services were paid for on a functional basis whereby separate remuneration was paid to depot owners, wholesalers, self-wholesalers and retailers, and this encouraged supplies to pass through as many hands as possible. Some retailers were using the services of a wholesaler for the first time, because there was no financial incentive to deal direct with the farmer.[2]

Tomatoes

The functional payment for services which may or may not be rendered has also been criticised in other trades. The Ministry of Food has divided up tomato importers and merchants into first-hand salesmen, primary wholesalers and secondary wholesalers. According to Mr. Bramall, M.P. for Bexley, speaking in a parliamentary debate, the first-hand salesman may perform no other function than that of identifying a particular consignment, for which he receives a permitted margin of 1s. 6d. per 26 pounds. The wholesaler proper is entitled to draw a commission of 1s. 9d. for 26 pound. The high margin allowed meant that importers were paying the Dutch growers prices higher than those which they themselves were allowed to be paid when the tomatoes reached this country.[3]

Meat

Similar criticisms were made by the same speaker with reference to the meat trade. "The Wholesale Meat Suppliers' Association is paid much more than covers all their operating costs, and then there is enough to pay to each wholesaler who was wholesaling in 1938 a percentage—I think 1¾ per cent—on each man's turnover in 1938. If a wholesaler had a turnover of £50,000 a year, which was by no means unusual, he can look forward, without doing any work for it or taking any active part in the business of meat distribution, to £1,000 a year merely from

[1] Ibid., p. 17. [2] *Economist*, 19.6.43. [3] *Hansard*, 27.6.47.

that fact that he was a meat wholesaler who had a certain turnover."[1]

Mr. Walkden, in the same debate as Mr. Bramall, referred to the new code which has grown up and fastened itself on the trade since the war. He stated that "A vast margin of profit is being gathered by irresponsible people, who have no responsibility whatever to society other than exploitation." To the extent that this is true the fault lies with the method of price-control, or rather to the inherent opportunities for such profits due to the combination of price and market control.

On the other hand, the Ministry of Food has been criticised, even by members of parliament who had spoken against the high cost of distribution, because it had been too niggardly with respect of certain margins enjoyed by other middlemen; which shows the inherent difficulty in attempting to fix what is a "just" price for carrying out a particular function. A good point, however, was made that in the vegetable trade growers were quite free to by-pass every link in the chain of distribution for commodities which were uncontrolled. Generally the grower prefers to go to an agent at a large market where there are a large number of buyers because he gets a more stable price there.[2] This is, of course, a tribute to the normal method of distribution of fruit and vegetables, a method which has excited much comment but which in many ways has had, perhaps surprisingly, the support of the Minister of Food.

Perishable commodities, fruit and vegetables

Fruit and vegetables are examples of commodities which are very difficult for a government to control. This is partly because of the perishable nature of the commodity where any profit margin fixed would have to cover loss and deterioration. Also because the "commodity" is not standardised. As was pointed out by Dr. Summerskill, if lettuces are controlled by weight there is nothing to stop a dishonest retailer from dipping his lettuces in water before selling them.

An example of this difficulty is seen in a report which was given by the Secretary of the Retail Fruit Trade Association with reference to a consignment of lettuces sent to a retailer. Owing to

[1] *Hansard*, 27.6.47, col. 902. [2] Dr. Summerskill, *Hansard*, 27.6.47.

the method of packing two-thirds of the lettuces arrived in an overheated condition and so had to be thrown away. The price to the retailer was 1½d. each, so that the grower was probably paid 1d. each. After allowing for the waste, the cost of each sale to the retailer was 4½d. and the selling price was 6d. This is a gross margin on selling price of 25 per cent, which does not appear to be unreasonable, but which would appear to be extremely high if it were stated that a lettuce which cost 1d. from the grower was sold for 6d. to the public.[1]

It is because of difficulties similar to the above that the Ministry has little interfered with the normal market mechanism. It has not generally imposed price regulations in spite of much criticism from various sources, informed or otherwise. One method of cutting the retailer's margin is to devise a more effective method of distribution, and periodically we witness direct to the public movements, of which the stall at Croydon in the summer of 1947 was a well-known example. This venture ceased in December, 1947. The reason for the closure of the stall, according to a statement issued to the public, was that the neighbouring retailers were undercutting the direct sellers. This proves that there is something in the existing method of distribution.[2]

As has been stated above, there has been much post-war criticism of the distributive side of fruit and vegetables. Certain practices of a restrictive nature had developed in the trade. Yet in spite of a certain clamour for government control of the market the Minister of Food, Mr. Strachey, took the opposite course and quite rightly gave additional freedom to the trade. From 1st September, 1947 entry to the trade was facilitated and no licences are now required for the sale of English fruit and vegetables. Throwing open the trade, and making entry to the wholesale side easier, is intended to introduce more competition which will correct abuses and lower prices. While the Ministry of Food may be criticised on other counts it must be recognised that it is not operating on any doctrinaire principles. In fact some of the speeches of the Minister are able defences of the free market system, and could be incorporated into Adam Smith's *Wealth*

[1] *Fruit, Flower and Vegetable Trades' Journal*, 27th September, 1947.
[2] Ibid., 6th December, 1947.

of Nations without in any way spoiling the continuity of thought to be found there!

Price control checks supplies

Price control of commodities, instead of protecting the consumer against high prices, may have the effect of depriving the consumer of the commodity altogether. Each year when certain fruits are controlled there is a chorus of complaints from buyers that they are unable to buy the goods of which the price is controlled. For example, in May, 1947 there were a fair number of gooseberries to be found in the shops at about 2s. 6d. a pound. When on June 8th the price was controlled at 9d. a pound not one was to be seen in the shops. Apart from the fact that at 9d. a pound consumers' demand would be much greater than when the price was 2s. 6d. a pound, due to the law of diminishing utility, the supply apparently was nil. The only explanation which was offered was that the growers did not find it possible to distribute through the normal channels at the controlled price and were selling to "trippers" at their own doorsteps. This is a development of the idea of distribution direct from consumer back to grower, as distinct from the grower to consumer movement. The costs of distribution of the commodity are thrown on the consumer.

Wheat

The wheat shortage in France in 1947 has been attributed to a miscalculation of the prices by the authorities. Stocks did not come on to the market and it was believed that the reason for the deficiency was because the peasants were hoarding their stocks of wheat and feeding it to beasts rather than sell it at the low controlled price.[1]

Onions

In 1947 a further example occurred in Britain over the control price of imported onions. According to the *Fruit, Flower and Vegetable Trades' Review* the maximum price of onions imported from the Mediterranean was fixed so low that importers were unable to import. The price of onions in Holland was approxim-

[1] *The Daily Telegraph*, 24th April, 1947.

ately 23s. 7d. a cwt. and the British controlled price was equivalent to 20s. 6d. f.o.b. a Dutch port so that none could be imported. The home price was 4½d. a pound. The retail price to the consumer if the Dutch price had been paid would have worked out at 5½d. a pound. So the public were protected by not being charged more than 4½d. a pound for onions which they did not get, instead of having the opportunity to buy the commodity at an extra penny a pound. No doubt many consumers if they had been given the opportunity would have been glad to have paid 5½d., but price control denied them the chance.[1]

It has been stated that price control of mackerel kept supplies off the market. According to Mr. Douglas Marshall, M.P., fine mackerel were sold in London in 1768 at 1½d. each, and the present control price is 3s. 7d. a stone of about thirty fish, almost the same price as two centuries ago. Owing to the great increase in the cost of boats, nets, etc., it did not pay to catch this fish within the control price.[2]

Coal and fish

The classical example of price control preventing supply to the market, happily short-lived, occurred in January, 1948 in the trawler fishing industry. The National Coal Board increased the price of bunker coal to trawlers by 25s. a ton, with the result that the majority of the boats did not put to sea. Apparently bunker coal was charged as export coal, and when the export price was raised the increase was applied to British trawlers. The export market can take care of itself, being in general competitive among a number of countries, and consumers abroad are not forced to buy coal from this country. But British trawler owners have to accept the local price and at the same time sell their product in the local market. The price of fish is controlled, so that the increase in costs could not be passed on in the selling price. Consequently the fishing boats found themselves between the Scylla of the monopoly seller of coal and the Charybdis of the maximum price. The squeeze worked and a large number of boats stopped fishing. The matter was soon settled by the Coal Board charging the home price increase

[1] *See* the issue for 13th December, 1947.
[2] *Hansard*, 23.6.47.

only, namely 2s. 6d. a ton, and the industry resumed its normal operations.

The maximum becomes the normal price

The fixing of a *maximum* price often has the tendency to induce in traders' minds the belief that that is the correct or "normal" price, so a high price will tend to be retained long after the conditions of supply have altered. If sales are slack at the controlled price, that price will be kept in the belief that demand will eventually take off all the supply. Instead of judging the situation by its commercial factors there is a tendency to believe that the published or official price is the "natural" price. This was certainly true with tomatoes in the summer of 1947, where the high prices still marked after there had been a plentiful crop were attributed to faults in the distribution machine engendered by the high maximum prices.[1]

Similarly in spite of an excellent harvest the price of apples remained high. There was here no price control because of this large supply; but the bad habits of trading brought about by the sheltering hand of price control of other commodities meant that distributors thought that they could obtain what prices they liked. Consequently the Ministry of Food reimposed price control of apples from 1st February, 1948. The *Fruit, Flower and Vegetable Trades' Journal* was of the opinion that the control was justified and that it was the fault of the trade itself which had brought these matters to a head.[2]

It may perhaps be urged in mitigation that the trade, like so many others, had got into bad habits due to general control and to what is known as the conditions of "the sellers' market." The retailer was unable to apply ordinary business considerations to what had then become an unknown and abnormal situation. He accepted the belief that because there was no legal maximum price, no price, however high, would be unjustified. The absence of a "ceiling price" was taken literally to mean that "the sky was the limit"! (There are certain retailers who advocate the retention of price control for all time in the belief that because someone fixes a price they will always be able to realise that

[1] *Fruit, Flower and Vegetable Trades' Journal*, 19th July, 1947.
[2] Ibid., 31st January, 1948.

price, and therefore they are exempt from the price competition from other retailers. These people are confusing price control coupled with a shortage of supplies with a more normal situation when supplies are plentiful and customers are able to make their own choice. Increased supplies would bring down consumers' demand prices in the long run, no matter what maximum were fixed by an outside body.)

In fact, retailers may believe that they have a "moral" right to the maximum price and there is something reprehensible in obtaining a lower price. Evidently it had been the practice of certain retailers of utility furniture to cut their price below the permitted maximum in order to compete with local Co-operative Societies, who paid dividends on furniture sales. This practice, which of course lowered the cost to people trying to furnish a home for the first time, did not command universal approval. "Firms which advertise utility furniture at prices lower than the permitted maximum, offer discounts or 'a rug thrown in with the lot,' are working against the trade's interest. . . . Quite often the retailer who undercuts does not realise the full consequences of what he is doing (*sic!*) and faced with the opprobrium of his fellow traders thinks twice."[1]

Real price unknown under control

When prices are controlled at below their natural level traders are placed in a position of difficulty when control is removed. It may be apparent that a certain price is too low, i.e. at *that price* the demand is greater than the supply, but it is of course not apparent at what *other price* the demand will be equal to the supply. This was exemplified in the case of nuts before Christmas 1947. The Ministry of Food had previously purchased a supply of nuts for distribution at Christmas. It quite rightly decided that the commodity was not of an essential nature and that it was not worth devising a special distribution scheme for an occasional sale. It therefore decided to leave the price and the distribution to the forces of the market. The nuts were uncontrolled and auctioned to the trade. The price was fixed by the competitive bidding of the various wholesalers, who would be influenced in the prices which they were prepared to offer by

[1] *Furniture Record*, 3rd October, 1947.

the prices which they believed that the retailers would pay them for the commodities. The retailers would regulate their buying by the quantities which they believed the public would buy at the market price.

Prices went high. It has been stated that the Ministry made a profit of 250 per cent on the cost of the nuts to them and the Ministry has been much criticised by the trade.[1] The only real basis of criticism could be that the quantity purchased from abroad was too little, thus causing the high auction price. But that raises the further issue as to whether foreign exchange should have been spent on additional supplies of nuts or on other foodstuffs, which is a question of wider significance than the Christmas auctions. Given the *existing* supply of nuts on hand the Ministry is not to be criticised for allowing the ordinary market mechanism to take care of the distribution. As it happened the trade overbid. Prices in the shops proved to be higher than the public were prepared to pay and there were large unsold stocks. After Christmas prices fell and considerable losses fell upon traders. It had been so long since there had been a free supply that it had been extremely difficult to estimate the demand prices of the public. The bidders were not to blame, they were unfortunate in that the ordinary knowledge of market conditions was denied them.

Rationing and the profit margin

Where the government controls the profit margin it has to bear in mind that the distributors of the commodities in question have to cover their normal expenses and profit out of this margin. This margin is only the gross margin and not the wholesalers' or retailers' net profit. If the margin is fixed too high it will attract fresh people into the trade, which is not the object of the price control; if the margin is fixed too low it will involve the traders in losses.

In the summer of 1947 new price schedules were published for sweets and chocolates and this reduced the gross profit margin from 20.83 per cent to 16.6 per cent on chocolate bars and sugar confectionery sold by the piece, and from 33.3 per cent to 26.6 per cent on the cheaper types of confectionery sold by

[1] *Fruit, Flower and Vegetable Trades' Journal*, 13th December, 1947.

weight.[1] These rates would be calculated to cover the costs of distribution of the commodities concerned which are rationed by quantity. In January, 1948 the ration per head was reduced from 4 oz. to 3 oz. without any alteration in the permitted margins. This would cause a fall of 25 per cent in the gross margin and a greater fall in the percentage of net profit. Owing to the alterations which would come about in the price of chocolate from Africa, it was estimated that distributors would receive just over £23 millions for dealing with the new 3 oz. ration as against £24 millions they then received for handling the 4 oz. ration. (It is estimated that the cost of the old ration to the public was £84 millions and the cost of the new, including the increased chocolate prices, £80 millions.)[2]

Therefore a loss of one million pounds is thrown on the trade owing to the operation of a reduction in the allowed ration and of the price control of the commodity. It may be reasoned that as there is less to distribute the earnings should be less. Yet one can hardly blame the shortage of confectionery on to those people who have entered the retail trade with the best of intentions and to charge the loss to them. It would be equally illogical to share the million pounds loss among the salaries of Cabinet Ministers.

Coupons and the profit margin

New price schedules were applied to the drapery trade on 31st January, 1947. It was estimated by the Board of Trade that sales for 1947 would be half as much again as in 1945 and that the draper must reduce his expense ratio from 20.6 per cent to 18.7 per cent, and that the benefit of the increased business must be passed on to the public in the form of lower prices. This meant that if the retailer were able to increase his sales to 50 per cent above those of 1945 his gross margin would be the same, and he would obtain no more for doing the extra trade; if sales did not increase he would be definitely worse off. It was contended by the trade that expenses were tending to rise because of wage increases and that the Board's estimates of the increase in trade were too optimistic. A particular point was made that there was not a 50 per cent increase in cash turnover in terms of

[1] *Hansard*, 2nd July, 1947. [2] *Confectionery Journal*, 1st January, 1948.

coupons. The Board proved to be only too wrong. The fuel crisis of February cut down instead of increasing the quantity of textile goods available. The trade had a reduced profit margin and a reduced trade at the same time.

Eventually the Board of Trade recognised the facts and the cuts in the retail margin were restored in June, 1947. The trade was told that the restoration was justified "for the time being," so it can be presumed that if supplies later increased the margin would be further cut.[1]

Fashion goods

The drapery trade is faced with a different problem from that of the confectionery trade. In dealing with fashion goods, unless exactly the right quantities are bought at the beginning of the season the retailer will either disappoint his customers or have some unsold stock at the end of the season. This unsold stock will have to be sold at a reduced price in order to clear it from the shelves. In some cases the price reduction will carry the price below the cost, so that the goods are sold at an absolute loss. Therefore in fixing his normal "mark-up," the retailer takes into account that all his purchases will not be sold at this profit margin. He is satisfied if his average margin is sufficient to cover his expenses and necessary profit. Where prices are fixed for him no allowance has been made for this factor, as during periods of acute scarcity all normal stocks can be cleared at the permitted price. As supplies increase (as the Board of Trade said that they would increase), then the factor of "remainders" increases in importance.

Even in 1944 the difference between gross permitted margin and gross realised margin was considerable. The Board of Trade investigated the margins of 2,672 non-multiple cash retailers and the gross margins, excluding discounts, actually realised were 26.62 per cent on turnover. In 1945 the figure had declined to 26.08 per cent. The difference between these figures and the permitted 30 per cent was made up of mark-downs, pilferages, deteriorations, etc. Any increase in trade in fashionable goods would increase the difference between the permitted and the

[1] *Drapers' Record*, 12th July, 1947.

actual margin.[1] The trade may lose on the swings, but the profits on the roundabouts are controlled.

Price control here has also helped to keep goods off the market in the fashion goods line. At the end of 1947 a number of wholesale millinery firms were trying to dispose of "job lots" at much reduced prices. But as price control limited the retailer's mark-up on his cost price, it did not pay him to stock these cheap lines. The bigger the price reduction by the manufacturer the lower the profit of the retailer, so the less these goods were wanted by the trade![2]

War- and peace-time control

The necessity for price control during the war of 1939–45 has been generally admitted, because the objectives of the control were agreed on all sides, and control was limited to these special objectives. "The object of the price control of food in Great Britain was not to rationalise the food trades, nor to apply any particular theory about political or social organisation, but to contribute as much as possible towards winning the war. On the one hand the Ministry attempted to keep food prices as low as possible and to keep the price of food as steady as possible, in order to avoid labour troubles. The second object was to avoid malnutrition among the poorer sections of the population: all their work was subordinate to those two ends," is the judgment of Mr. Henry Smith.[3] In the non-food trades the position was different. Instead of maintaining the pre-war standard of consumption it was necessary to cut down expenditure on certain items so as to set free productive resources for use in war industries; and much of the control, clothes rationing, preventing the opening of new shops, etc., was directed to this end. It is not the purpose of this essay to attempt to criticise the measures which had to be hurriedly put into operation under the stress of war. The fact that they were able to work with comparative smoothness shows that the objects of the control were generally accepted.

In the post-war period the position is entirely different.

[1] *Drapers' Record*, 10th May, 1947.
[2] *Drapers' Record*, 6th December, 1947.
[3] *See* Henry Smith, *Retail Distribution*, 2nd edition, where the whole of Chapter VI should be consulted on this question.

Here it is not a question of one overriding demand for one "commodity," the winning of the war, but it is a question of the many wants of different consumers. The many individual ends replace the one government end.

In part, the war-time policy of controlling the price of food and subsidising the cost to the consumer has been continued and even extended. But retail price policy has gone further than this and taken on other aspects.

The post-war inflation of the currency by putting more money into circulation has caused prices to rise. Instead of checking the inflation in time an attempt has been made to counteract complaints about the rising cost of living by "pegging" prices at their existing levels. Here it is neither a question of basic necessities of food which are subsidised out of general taxation nor of diverting resources to war purposes. It is an attempt to tackle a major problem of disequilibrium caused by inflation through the medium of the price control of a large number of different commodities.

In the spring of 1948 a series of Orders were issued controlling prices at their existing level. "Traders will gasp with incredulity at the latest development in the fight against inflation. With to-day's publication of the Board of Trade's prices standstill orders, we reach the crowning absurdity of government by petty detailed regulation. The very list of articles in the Miscellaneous Goods (Maximum Prices) Order, 1948, is almost an invitation to levity."[1] Apart from the fact that it is impossible to check inflation by attacking the symptoms instead of the causes, therefore the Standstill Orders were useless in bringing about their declared objects, they are subject to further defects.

The Orders were to come into operation on 15th March. They were so unworkable that the date of operation was postponed to 26th April and later to 3rd May. In the meantime many obscurities had been cleared up. It was becoming possible to understand them. Some of the items controlled at their prices in the base period (the two months ending 31st January), owing to their seasonal nature were not produced at all in that period. New items could not be controlled at a base price, so they had to be controlled at cost of production and sale plus 5 per cent,

[1] *The Financial Times*, 25th February, 1948.

reintroducing the old evils of "cost-plus." Thus we are getting a series of conflicting methods of control for many similar types of goods. This is a strong inducement for manufacturers to change to the production of other commodities, not because they are more wanted by the community but because by so doing the manufacturers come under a different and more workable system of controls.

Conflict of controls

Many of the peace-time controls are bad enough in themselves, but the position is completely indefensible when the same commercial operation is subject to two or more different controls. It is possible to satisfy the requirements of one control and yet fail to satisfy the requirements of another. An example of the double type of control is where the Board of Trade fixes a maximum price for the sale of an article and at the same time fixes a maximum profit which may be made by the firm.

In October, 1948 a Leeds clothing firm was fined thousands of pounds for making an excess profit in 1946. The managing director of the company had studied American methods of production and by subdividing the work of his factory he was enabled to produce articles at a low cost. Goods were prices from the factory at well below the permitted maximum price (known in the Board of Trade as a "ceiling" price), whereas the prices charged by the firm's competitors were all up to the maximum. As a consequence of the efficiency of the firm and of the low prices charged there was a very great increase in total turnover. On the cost-plus control, quite independent of the control of selling price, the firm was permitted to charge the cost of manufacture plus 5 per cent if a manufacturer used his own materials, or 6 per cent if the work was what is known as cut, make and trim.

It was contended by the Board of Trade that any competent auditor could find out to a penny what costs of production of an article were and then there was the simplest of sums to find out what was either 5 per cent or 6 per cent, to add that on, and that gave the permitted price.

This is incorrect. "Any competent auditor" knows the difference between a cost and an estimate. No firm can know

at the time that it sells an article what is its cost of production over a long period. Nearly all costs are composed of two parts, the fixed and the variable. Generally the costs of materials and of labour employed on the job are known for certainty at the time of use. But the additional costs, the "overheads," will vary with the number of units manufactured. While they may be *guessed* beforehand they can only be *costed* at the end of the trading period, when all the relevant factors are taken into account. By that time it is too late because the goods have already been invoiced to customers.

This can be illustrated by a simple example. It may cost £100 to set up a type, and it may cost in labour and materials £1 for every copy run off. If one copy is taken the cost is £101. If 100 copies are taken the average cost is £2 a copy, £1 direct costs and £1 as a share of the overheads. If the firm estimates beforehand that it will sell 100 copies, then its permitted price is 42s., i.e. cost price plus 5 per cent. If the maximum price at which it can sell, according to some other Order, is 50s., then it can sell below the maximum, thus benefiting the public, and make the profit allowed. If, however, by selling cheaply, its sales go up to 200 copies the overhead charges are spread over a larger output, the average cost is 30s., and the firm makes an efficiency profit.

Cases of this nature should not occur. If the object of the regulations is to make business as difficult as possible; to trip up the efficient firms; to collect a large revenue in fines; then the Orders are extremely well designed. If the object of the Orders is to protect the public against high prices, then the fixing of a maximum price is sufficient. If a firm chooses to sell below the maximum price it is doing its part in reducing the cost of living.

Economic welfare demands that goods be produced as efficiently as possible. The obvious way out for a firm which is fined for producing efficiently is to become less efficient; to waste materials; to use labour uneconomically; and for the owners of the firm to charge up to themselves higher salaries. If the public is protected with a maximum price, then the State should have no further interest in the costs of production. In any case, it will take a not inconsiderable share of the efficiency profits

through the offices of the Income Tax collector, so it should be concerned that businesses do earn good profits.

Purchase tax

While the State is concerned that people do not pay too much for certain articles, as walking sticks, dart boards, etc., it is also interested that the public do not get these articles cheaply. Hence many articles are subject to varying and changing rates of purchase tax. Again we have the conflict of policy. Prices are "frozen" at a "ceiling" level to keep down the cost of living. Goods are subject to purchase tax to "mop up purchasing power."

The sole justification for interfering with the margins of profit made by the manufacturer, the wholesaler and the retailer is to benefit the consumer. If it is believed that he is suffering from high prices, then everything possible should be done to bring down those prices. The interference with other citizens is only incidental to that main object. If it is believed that the demand for commodities must be checked to save resources which can be used for other purposes, then the prices must be allowed to rise. The two policies of increasing and lowering prices cannot be right at the same time. One policy only may be correct. It may be that not even that policy is right. If margins are controlled to benefit the consumer because he is too poor to pay high prices, then the consumer cannot afford to pay purchase tax. If purchase tax is levied to raise the price the fixing of the income of the distributor is completely unfair because the incomes of others, such as wage-earners, are not fixed by the State.

In many cases the rate of purchase tax is so high that any feasible reduction of the distributive margin would cause a negligible fall in the price of the commodity to the consumer; distribution costs are becoming a progressively smaller element in the selling price of goods.

The retailer has to pay purchase tax when he buys the goods and he is not allowed to add any margin of profit to cover the tax. This is equivalent to a reduction in his trading margin. The financial costs of holding stocks are increased. If for any reason he has to sell the goods at a lower price than the per-

mitted price, he is allowed no rebate on his tax. As his margin is a smaller proportion of his selling price a moderate percentage reduction in the price, *including tax*, may well absorb the whole of his profit. A large reduction in price will mean that he loses part or all of the money which he has paid to the government in tax.

The retailer is subject to a further risk. The tax is levied on the consumer; the retailer is merely acting as an unpaid agent of the government. If, however, rates of purchase tax are reduced the "collector" is allowed no refund of the tax he has remitted. He cannot recover the tax from the consumer as competition forces down the price. This may not be a serious matter when rates of tax are low and changes are infrequent; but when two national budgets are introduced in a year, which involve considerable changes in purchase tax, then it may be a more serious matter. In some cases in 1948 rates were twice increased, and then reduced to their original level, resulting in heavy losses to individual firms.

The result is that retail businesses dealing in commodities subject to purchase tax are extremely reluctant to lay in large stocks, particularly before one of the expected budgets. Turnover becomes smaller, hand-to-mouth buying increases transport costs by the multiplicity of small parcels being carried, and channels of distribution become clogged with goods. The uncertainty prevents the manufacturers planning ahead.

The peculiar result is reached that the extension of long-term government planning in the interests of stability in the economic system leads to short-term business planning. There is an increase in the risk of enterprises and greater instability.

CHAPTER IX

HOUSING

"In countries which have long been rich you will frequently find the inferior ranks of people in possession both of houses and furniture perfectly good and entire, but of which neither the one could have been built, nor the other have been made for their use."—ADAM SMITH, *The Wealth of Nations*.

THE standard of housing that a country can afford will depend upon two factors. It will depend upon the real wealth of the country—upon the general level of productivity of industry. A rich, advanced country will be able to afford better houses than a country with a primitive standard of living. It will depend further on the standard of housing which is wanted in relation to the other wants of the community. It will be governed by the urgency of demand for the services of housing within the income limits which are available to supply all the multifarious wants of the individuals composing that community. In other words the demand for a particular standard of housing will depend upon the relative position which the utility of housing occupies in the consumer's scale of preference. It will depend upon what proportion of a man's income he is prepared to devote to his housing needs, bearing in mind the income which he is prepared to devote to his other needs.

Some people or some communities with a relatively higher standard of living may be willing to devote only a smaller proportion of their real income to the provision of "shelter," while other people with a lower standard of living may devote a larger proportion of their total resources to "shelter" instead of to other wants. This fact is often overlooked when discussing the housing situation. There is no absolute fixed "propensity to consume" the services of housing.

The supply of housing

The provision of housing may be done in either of two ways. The occupier may own his house or he may find a house owner

who is willing to let him have the use of the owner's house for the payment of a rent. Likewise houses may be built with two objectives, either to sell outright to an owner-occupier or they may be built with the object of letting. This letting may be done either by the original builder or by a purchaser who is using the house as an investment for himself. In addition to the houses which are built as investment properties there is a further supply of rentable houses. Houses may be built for personal occupation but later, owing to changes in personal circumstances or to fashion, they may not find a purchaser of the same social position.

Neighbourhoods which were once the fashionable quarter of a town have a tendency to decay with the growth of that town. The richer inhabitants move out to the suburbs or the country. The houses that were built for their own occupation come on to the market and are available for other people who could not have afforded the original cost of their construction. A considerable proportion of the housing of people of moderate means is provided by the utilisation of the "second-hand" houses of people of greater means. The change in relative incomes among different classes, the lack of servants to run big houses, smaller families, higher taxation on higher incomes, work towards the use of smaller houses. Therefore the larger houses come on to the market and their price is not affected by their original usage but by the lower demand of people with smaller incomes with lesser demands for house-room. Hence these large houses are commonly sub-divided into flats and so house a larger number of families. The supply of housing to the poorer sections of the community is consequently greater than if houses served only the original market for which they were built.

Nineteenth-century housing

The problem of housing that has given rise to various methods of price control, whether of new houses or of the rents of houses let to other people, is no new one. In fact, the post-war shortage of houses, serious as is the problem, would probably have been considered a minor matter a century ago. At the beginning of the nineteenth century there was a rapid growth of population. The concentration of this larger population into great urban

industrial areas was more than a question of a shortage of houses, it was a question of their non-existence.

The increasing population at the time of the Industrial and Agricultural Revolutions had to be housed somehow. Generally the housing was provided by the speculative builder, who built ahead of orders to satisfy a growing demand. He built, therefore, to a standard of housing which would command a response among the people of the time. He built houses at a cost which people could afford or were willing to pay. Poor people with low wage rates could not afford to pay a large sum in rent, so cheap houses were provided. If better houses had been built they could not have housed the new working classes. The methods of the builders have remained the same to this day, "the land rented in hope, materials secured on credit, a mortgage raised on the half-built house before it is sold or leased, and a high rate of bankruptcy. . . . Much and deservedly criticised as the jerry-builder has been, no one has even suggested how the ever-swelling British urban population could have been housed without him."[1]

Professor Clapham has also pointed out that some of the criticisms against the jerry-builder are unfounded. That the towns were not planned and often neither paved nor drained was not the jerry-builder's fault; nor could he supply first-rate sanitation when the water-closet and the iron water main were barely invented, and a cheap method of making earthenware drainpipes was unknown.[2] The houses were built according to the knowledge and the means of the time, and they were not built according to the standards and the wealth of a later age. The "back-to-back" houses of the new industrial areas, poor as they were, were at least houses. They did not compare unfavourably with the village houses from which the population had come. The fact is that the growth in the standard of living in the nineteenth century brought about by the Industrial Revolution took the form of better food and clothing first, housing had to wait its turn for the new improvements in standards.

Capital and enterprise went first into agriculture to produce

[1] Clapham, *An Economic History of Modern Britain*, Vol. I, p. 164.
[2] Clapham, *op. cit.*, p. 165.

more food. Later they went into canals and railways to enable the increasing population to be fed. It was not until the twentieth century that resources were available for other improvements in living standards.

The supply of housing was therefore left to the open market *and the demand was met*. There was nothing to stop the building of better type houses and higher standard houses were built for those who could afford them, or who were willing to devote a larger proportion of their income to housing. In modern times the problem has been approached from a different angle, and there has been considerable interference with the normal market mechanism.

Twentieth-century wars

Although there has not been the same proportionate increase in population during the twentieth century affecting the demand for housing, there has been the effect of two major wars on the supply of housing. Housing has been affected on the supply side more than on the demand. There has been the further complication of the great fall in the value of money which has caused the State to interfere with housing.

The State has intervened in two ways. It has controlled the price at which existing houses are let for rent and it has intervened in the building of new houses.

A further sub-division is necessary. Rent control is applied in two ways to "old controlled" and to "new controlled" houses.[1] Old controlled refer to houses built before 2nd April, 1919, whereas new controlled houses refer to houses which were controlled by the Act of 1939; i.e. to pre-1914 war or to pre-1939 war. While there are important legal differences between the administration of the law concerning the "old" and the "new", the economic effects of the different Acts are very similar. (It must be noted that it is purely the economic effects which are being considered here.)

Briefly the position is that certain types of houses, those of lower value, are controlled at their "standard rent." The standard rent is the rent at which the house was let on 3rd August, 1914 old controlled), or on 1st September, 1939 (new controlled).

[1] Ministry of Health, *Rent Control in England and Wales*, 1946, p. 2.

Certain permitted increases in rent above the standard may be made, such as for structural improvements or to compensate for increases in rates where the landlord pays the local rates, plus a permitted increase of 15 per cent of the net rent of old controlled houses or of 25 per cent in the case where the landlord is responsible for the repairs.

Certain houses are therefore controlled at their 1914 money value plus at the maximum 25 per cent, and houses which do not come within the pre-1914 class are controlled at their 1939 rent.[1]

The objects of the rent control Acts are to protect tenants against an increase in their rents, to prevent landlords from gaining an extortionate profit due to a war-time housing shortage. In 1920 the limits to rent control were principally bound by "working class" houses, and the Act was therefore a partial one only. It applied to dwelling houses of which the rateable value did not exceed £75 (£100 in London). It is to be noted, however, that where the landlord is a local authority the tenant has no protection, as local authorities are outside the provisions of the Acts.

Rent control and the value of money

The economic effect is that the rents of houses are fixed in money terms on a basis of the rents which were payable at some previous period, "at pre-war" rents, but different wars are taken as a basis for different houses. Where the rent remains the same in money as it was in 1939 or in 1914 it amounts to a reduction in the real income to be obtained from letting the property. The money income to the landlord is the same, but its purchasing power has diminished owing to the fall in the value of money. In the same way the real burden of the rent payable by the tenant has diminished due to the rise in his monetary income—this is assuming what is assumed in the Acts, that the tenant is "working class" so his money wages will have increased from what he would have received in 1939 or 1914. If the tenant is living on a fixed income he is then in the same position as the landlord; his income is the same but its real value has declined.

The underlying assumption behind this price control is

[1] *See Rent Control*, pp. 3–5.

apparently that the tenant is economically weak and must be protected, and that the landlord is a rich man who can well afford the fall in his real income. It may be that this is true in a number of cases, but the Acts say nothing about fixing the rents in relation to the income of the tenant or the income of the landlord, or about fixing it by some formula which will take into account the incomes of the two parties.

It may therefore be stated that the effect of rent restriction has been to cause a fall in the real rents of the property controlled. This would be the same as the government keeping the value of money constant without its value depreciating, a thing which most governments appear to find extremely difficult, and at the same time compulsorily reducing the rents paid for houses, except of course for council houses.

The idea that the landlord is rich and therefore quite able to afford this real cutting of his income probably comes from the nineteenth century, when the large landowner was a comparatively wealthy man. We are, however, not living in, nor legislating for, the nineteenth century. It is to be doubted whether this picture of the typical landlord is true to-day. With the break-up of large estates the typical landlord is probably a much smaller man.

It is a well-known fact that in past years much of working-class savings has gone into house property. The rich man with his larger income and his greater knowledge of the market will probably invest in stocks and shares instead of in house property. The poorer man probably feels a greater distrust for such investments, and in any case he does not possess sufficient capital to spread his risk over a number of enterprises. He regards, or did regard, house property as something safe which he and his widow could understand.

Very often the relation between landlord and tenant will not be the relation between the landlord and tenant of fiction. It will be between a landlord who has retired from work or a widow of a workman whose property is the sole or main means of support, and a tenant who is in a well-paid job and who is able to obtain increased wages in keeping with the increased cost of living. But such workman living in a pre-war controlled house has to be "protected" from his rapacious landlord.

The cost of repairs

The real income obtained from house letting is reduced in a further way. Out of the income received from his property the landlord usually has to provide for the repairs. No allowance is made for the higher cost of repairs; not only is his gross rent fixed in depreciated money, but his net rent after allowing for repairs is reduced. In many cases this is extremely serious. To effect even the slightest of repairs will absorb the income from several months' rent and landlords will therefore undertake the minimum of repairs. The result of this is that many houses are not being properly maintained, and the country is consequently living on its capital and not maintaining its housing assets.

A further result of this is to reduce the supply of houses for rent. Landlordism is a depressed industry, the landlord is one who has special legislation directed against him (with its consequent social obloquy), so investments in houses to rent are no longer sound propositions. It is little wonder that the complaint is made, somewhat plaintively under the circumstances, that before the war houses were built for sale and not for renting; houses were a good thing to get rid of.

House-building between the wars

The uncertainty in housing and in general business conditions after the 1914 war are reflected in the numbers of new houses built. The output of houses built by private enterprise as a business proposition was low. Most of the output was supplied by local authorities with government assistance or by private enterprise with similar assistance (the "subsidy house"). But even with the uncertainty introduced into the industry by price control and the various intentions of different governments with regard to the policy of subsidising house building, by 1923 private enterprise had begun to overtake local authorities. And thereafter it retained a long lead[1] and of over four million houses built between the two wars private enterprise provided more than three million. As can be seen from the graph on page 116 house building was steadily increasing up to 1928, the biggest factor in the increase being caused by the rise in the curve of

[1] *See Housing*—a general information pamphlet issued by the Ministry of Health.

houses provided by local authorities. The fall in 1929 was largely due to a reduction in the number built by local authorities and in the "subsidy" houses by private enterprise.

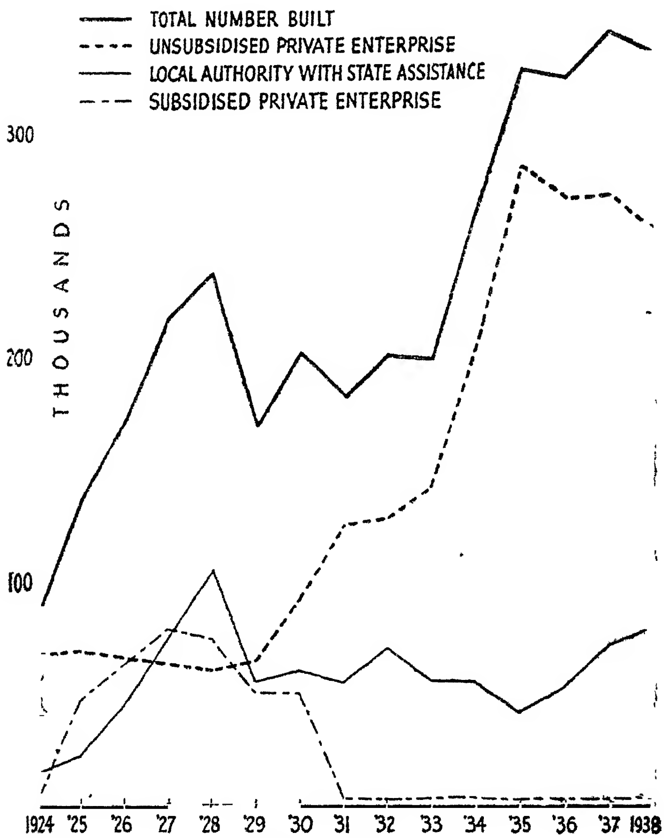

Diagram 7.

Number of houses built in England and Wales 1924–1938.

While total buildings continued to fluctuate to 1933 caused by fluctuations in the government subsidised houses, there was a steady increase in the number built speculatively, and after

that year the curve of total houses built lies only a little above that of those built by private enterprise. It must be pointed out that the figures for private enterprise houses do not include houses with a rateable value of over £78 a year (£105 in London), so that the total number of new houses constructed must exceed the figures from which the graphs have been constructed.

If there is an adequate number of houses to suit the demand for housing rent control will be unnecessary. It is a commentary on the governments' attempts to solve the problem that the real solution, a vast amount of house building, occurred after the subsidy to private building had been virtually withdrawn, and after local authority building had passed its peak. It was, of course, the low interest rates of the depression years which caused house building to be profitable; and it was this vast amount of house building which increased general incomes and helped the country to climb out of the depression. But it was not subsidies, nor exhortations, nor threats, nor long-period planning which provided the houses. It was the ordinary forces of the market, and the forces of the market were able to bring the results when the extraneous assistance was withdrawn.

Sale or rent

It might be objected that the majority of houses built in this way provided shelter for only those able to purchase their own houses, but that would be a partial view. If houses are built because people are willing to buy them the fact that these people are housed means that they are not in the market for houses to rent; more houses are available for those who do not wish to buy. If builders put up houses which people are not willing to buy then they must either remain unoccupied or they must be let to a tenant. Either way the houses are there, those who want to buy can do so. Those who do not want to buy are benefited by the buyers going off the market and ceasing to compete with tenants for the limited supply available. What is of importance is that the house should be there and not what was the *original* intention of the builder as to its ultimate method of occupation, as Adam Smith remarked in the passage quoted at the beginning of this chapter.

War damage

The war years undid the peace-time construction. The total destruction of 200,000 houses, serious damage to 250,000, the virtual cessation of building and the depreciation of existing property (largely of the rent-controlled type) caused, not for the first time, a serious situation in the country's housing. In 1945, therefore the government decided that the first priority be given to the building of houses for letting, and that local housing authorities be chosen as the principal instruments for building houses with generous Exchequer subsidies to help to bridge the gap between the present high cost of building and the "rents which those who need houses can afford to pay."[1]

The main supply of housing was expected to come from the local authorities. Direct control was established by fixing a four to one ratio between licences, not more than one house could be built privately for sale for every four which were built by local authorities for letting purposes.

In addition to the physical control over licences for raw materials, etc., price control was also established. Houses built for sale had to be built to conform to a maximum price level. This price level is below the actual cost of local authority building, even for temporary dwellings which are expected to last for a few years only. For example, the maximum price for sale has been fixed at £1,200, while in the same area a similar house cost the local authority and the central government about £1,600, so that the extra cost of building for letting only is £400.

The same result could have been achieved by allowing unlimited private building and for local authorities to purchase the houses from the speculative builder. The local authority could have let them to tenants with a saving of £400 per house to the taxpayer. It is suggested in certain quarters that the builder for sale is unable to build a house within the control price and therefore is forced to resort to "key money" and other devices to cover his costs, and that this device is rampant throughout the country. If so, and much of it is only hearsay, it is a reflection on the price control and upon its influence in creating the "black market" in the commodities which are controlled.

[1] *Housing*, p. 2.

Better type houses

While the above covers general criticism of price control there is a further and more special point of criticism of the housing policy. The justification for the present control is the special needs of the population due to the war. It is necessary to provide as quickly as possible the maximum amount of "house room." But the Ministry of Health is using its powers to further other objectives. Admitting by implication that pre-war council houses were not of the best standard, local authorities are to-day building better houses than before the war. The improvements made are to be found mainly in the size of the houses and in the standard of fittings supplied.

Larger and better houses use up greater quantities of materials and labour. As the main justification for the present policy is the *immediate* need, houses of a lower standard would satisfy that need better. It can be left to a later date the improvement in standards, which will be governed by what the country can afford in the future. The provision of better standard houses now means a longer queue for existing houses, and fails to satisfy the real problem of a shortage of present-day accommodation. (Peculiarly enough, the lower standard house, the temporary pre-fabricated house, seems to cost considerably more than the price which a builder is allowed to charge for a permanent house for sale.)

The truth of the contention advanced in this chapter, that the standard of housing which a country possesses will depend upon what that country can afford relative to the general productivity of industry and to the real wealth of the country, is well borne out by the revised housing programme. Dealing with the housing situation in isolation it is easy to make out a case for a rapid increase in the number of houses. But the provision of more houses brings us up against the age-old economic limitation that if we have more of A we must have less of B. The more workers who are employed in house building the fewer workers can be employed in other industries which also supply services which are essential to the community. The more resources which go into housing the less there are for other purposes.

"The timber imported in 1948 will govern the number of houses which can be completed in 1949. It is estimated that the amount of timber which can be imported during 1948 will be no more than sufficient for the completion of 140,000 houses. The government are providing for the number of houses under construction at the end of June, 1948 to be 210,000, and approvals of new houses during the remainder of this year and in the first half of 1948 will be granted to secure this result. . . . After June, 1948 there will be a progressive reduction (in the number of workers to sustain the rate of finishing new houses) as the number of new houses under construction falls below 210,000 with a consequent reduction in the number of people employed during the second half of the year."[1]

This after the building industry had been expanded and encouraged with government training schemes! The original schemes were more grandiose than could be sustained in the light of our reduced circumstances. And more houses were started than could be finished. Labour and materials were put into partly finished houses that are useless to anyone, because the expansion had been unco-ordinated and gave rise to the consequent bottlenecks. As a long-term policy with plenty of resources and time available the technique of having a large amount of "work in progress" is sound; but when the essence of the matter is supposed to be speed the smaller the proportion which is in the "pipe line" the better.

Selling price of old houses

Not only does the government control the rents of certain houses and control the building of new houses at the present time, it is also interested in the selling prices of old houses. In 1945 there was issued the *Report of the Inter-Departmental Committee on the Selling Price of Houses*,[2] which had considered whether it was practicable to control effectively the selling price of houses, thus preventing undue financial advantage being taken of the present housing shortage. The Committee was mainly concerned with the question of the practicability or otherwise of a system of control. But in its report the Committee declared that it thought that it was not within its province to

[1] *Capital Investment in* 1948, Cmd. 7268, p. 9. [2] Cmd. 6670.

make any recommendation as to whether a scheme of control was desirable or not. There are many forms of control which may be quite practicable but which are in no way to be considered desirable.

After explaining the reasons for the present position in housing, the war damage and the cessation of new buildings during the war, etc., the Committee says that "it is obvious that dwelling-houses now possess a scarcity value."[1] What other value could houses possess at any time? If houses were so plentiful that they became "free goods" they would have no value at all. It is because commodities are "scarce" that they possess a value. With abundance there is no value because no one is willing to give up something in exchange for a commodity which can be obtained for nothing. Further the Committee declares that as supply has been interrupted there is something unreal in speaking at the present time of the law of supply and demand. Housing exhibits a very real example of the workings of supply and demand. Supply has decreased, demand is the same or greater, therefore the price rises. Also the price is expressed in terms of money which has depreciated in value, therefore the present price rise is less in real terms than is apparent from a comparison of present and pre-war prices.

The Committee point out that as rents are controlled and the price of second-hand furniture is controlled there is room for the opinion that some control of the selling prices of houses is reasonable and fair. That is the argument that because there is some control it should be extended. It is an illustration of the principle that control feeds on itself and multiplies. A scheme of control was outlined in which the maximum prices at which houses could be sold were to be fixed by the Valuation Office of the Board of Inland Revenue, taking 1939 as a base with a percentage addition.[2] It is perhaps unnecessary to state that the buying or selling of a house at higher than the valued figure would add to the list of offences which can now be committed in this country and that suitable penalties would be imposed.[3]

The Committee quite fairly points out some of the objections to a system of control, objections which have been expressed on

[1] Ibid., p. 5. [2] Ibid., p. 14. [3] Ibid., p. 23.

behalf of professional men (estate agents, surveyors, lawyers, auctioneers, etc.). Some of the witnesses were of the opinion that no scheme of control was practicable; that control would keep off the market many houses which would otherwise be offered for sale; that it would aggravate the housing situation instead of alleviating it; that there would be the great risk of evasions with all the difficulty of checking them; and that control would be expensive and would prevent private people from building.[1]

The scheme of control which was proposed would have depended upon the ability of the Valuation Office to carry out the work and in order to do so it would have required a considerable increase in the staff. So that to institute a scheme of control which would not add one house to the existing stock labour would have to be diverted from other activities. The same amount of labour devoted to some export industry to earn the resources to buy timber would allow for a greater output of house building. This besides, providing more accommodation, would render schemes of rent control, building control, and selling price control all less necessary.

The "shortage" of houses

Besides the injustices which are perpetrated between different individuals in the community, injustices which in themselves are of no little importance in the conduct of the life of a civilised country, the operation of the Rent Restriction Acts results in further harmful effects. The injustice does not even have the merit that the purely economic results are desirable; on the contrary, the injustice results in a worsening of the economic position of the country; which is perhaps what should happen.

Rent control increases the shortage of housing and hence aggravates the evil it is intended to alleviate. As the point is so little appreciated it is necessary to explain it in some detail. The supply of housing which is offered on the market is no fixed amount. While it is true that at a given moment there is an absolute and fixed number of houses which are available for occupation, the amount of "house-room" or accommodation

[1] Ibid., p. 28

which may be offered for use is fairly flexible and can vary with changing circumstances.

Additional families may be housed without increasing the number of houses by the occupants of large houses sub-letting part of their own accommodation. Part of the problem has been tackled in this way where local councils have been able to requisition empty houses and convert them into flats. But there are other large houses that are not empty and are too large for their present occupants. If these people could be induced to sub-let part of their premises to others part of the strain on housing could be lessened. In the existing state of the law many are reluctant to do so. If out of a feeling of kindness a flat is let at a low rent, that first letting becomes the controlled rent at which the premises must be let in the future; that rent must not be increased. Even if the premises are let furnished there is always the possibility that the tenant will go to a rent tribunal to have the rent reduced.

It does not, of course, follow that the rent will be reduced. The tribunal is expected to fix what it considers to be a "fair" rent and this will largely be determined by the approach and attitude of the members of the tribunal. There is no absolute standard of "fairness" which can be universally applied throughout the country. Cases have occurred where a tribunal has increased the rent, but they are rare. (It is striking at the whole fabric of the law of contract where a tenant willingly agrees to a certain rent and can then get that contract set aside.)

While it is not suggested that the tribunals are not acting in a fair and proper manner they, like the Courts, have to administer the law as they find it, and their mere existence is the cause of housing accommodation being kept off the market. People who have no idea of what would be considered a "fair" rent for the use of their accommodation and who are in no absolute need of the income to be derived from letting their premises, are reluctant to put the matter to the test.

The law is heavily weighted in favour of the tenant, no matter how dishonest he may be in breaking his contract. As there is such a strong feeling that the landlord has few rights, is entitled to no consideration, that he is almost an "outlaw," is it to be wondered at that many people are reluctant to join

this pariah class? So houses which were occupied by once large families remain partly occupied.

A redistribution of housing

There is a further potential supply of housing accommodation which is kept off the market by the operation of rent control. In the past people have rented houses of a certain size because they have had a large family to bring up. The houses are now rent controlled at a low rent—low, that is, to present prices. The families have now grown up and married and dispersed. The old parents find themselves living in a house which is too big for their present and future needs. But it is a cheap house for them to live in, although it is "dear" from the point of view of the community that so much of the scarce resources should be used up in providing for so small a need.

Much of the pressure of overcrowding could be relieved if there could be an exchange of houses, so that those with large families could move into the larger houses and the older people could have the smaller houses which are more within their capabilities to manage. But with rent control the old people have a vested interest in their old house. As few local authorities provide small houses and as the Ministry of Health wishes to raise the standard of housing, movement would probably entail taking a house at a higher rental. Therefore people stay and the existing resources are wasted in that they are not put to their best uses.

Mobility of labour

The occupant of a rent-controlled house is a member of a specially privileged class irrespective of his financial position. He has a vested interest in remaining where he is. If he moves he loses his special income. This special income arises from the fact that if he is paying in rent 15s. a week for a house which is economically worth in the open market 25s. a week, then his tenancy is worth 10s. a week to him; part of his accommodation is given to him free. If he leaves that house and goes into one where he pays the true rent he loses his unearned and untaxed income. There is therefore every inducement for him to stay where he is.

Unfortunately the best interests of the country do not require that everyone stays where he now lives or remains in the district where he was once employed. Changing circumstances demand that there be a change in the numbers employed in different industries and in different localities. The policy of "taking the work to the workers" has its limitations. This is especially so where the new work is in such industries as coal mining or agriculture, which have to be carried out where there are coal measures or suitable agricultural land.

Leaving out of account the compulsory movement of labour of a slave economy the best method of redistributing labour into industries where its worth to the community is greater is by the offer of higher wages in the industries where the labour is required. This will attract labour away from those industries where its work is less valued by the community and the ordinary forces of supply and demand will bring about a result which is desired by the community.

But the worker who is contemplating changing his job because of the prospect of higher earnings may be deterred by other considerations, among which will be the question of housing. If he would be induced to move for an increase in wages of £1 a week which may be subject to income tax and if as a result of moving he loses his "unearned" income from living in a rent-controlled house, he may be positively worse off by making the change. As he stays where he is the community loses his services in the more essential occupation.

Part of the worker's real, as distinct from his money, wage therefore consists in giving him a certain supply of housing at someone else's expense. If he is to be given the equivalent of 10s. or a £1 a week, it may be that he would prefer to draw it in money and spend the money how he likes. It has even been suggested in some private discussions amongst economists that as the occupant of a rent-controlled house is in receipt of this unearned income his position should be regularised by charging him the economic rent of the house he occupies. He would also be compensated by the payment of a subsidy in cash of the amount which he is thus forgoing. It would not be practical politics to do so because the element of injustice would be so apparent; he would be getting a money subsidy which was denied to others. But the element of

injustice does not disappear by being covered up; by being exposed the absurdity of the position would be revealed, and possibly corrected.

At the moment the only people in the country who are in any sense mobile between different occupations are the owners of houses. If they can sell their existing houses at the current market price the sale should provide them with the means to purchase another house in a different district. Any control on the selling price of houses would check even this limited degree of mobility in the economic system. Whether the prices of houses are high or low does not matter to them provided that the cost of housing does not vary greatly between different areas. In so far as movement is taking place only between one set of house owners and another the price paid is a "paper" price and the market price is to that extent artificial.

The crowning absurdity of the position is reached where even local authorities which are building houses are unable to obtain necessary staff because of the difficulty of obtaining housing. One authority at least gave as its reason for the slowness in its housing programme the difficulty of obtaining qualified architects. Although large numbers had been interviewed none would take the positions offered because the local authority could not guarantee houses for the applicants.

CHAPTER X

THE COMMODITY MARKETS

THE industrial revolution and the improvements in transport facilities in the nineteenth century brought about a revolution in world commerce. For the local market supplying local needs was substituted the national market covering the requirements of a whole community. In many cases there arose a world market for a large number of commodities. Not only did the market widen but the range of commodities changed. Instead of spices, sugar, coffee, and tea being the staple goods of trade (i.e. goods of comparatively high value in small bulk) international trade became increasingly concerned with other products, wheat, cotton, wool, coal, and base metals which are commodities of comparatively low value compared with their bulk and cost of transport.

This change necessitated a change in commercial methods. An organisation had to be developed capable of handling large supplies from a great variety of sources and distributing these supplies over a wide area and among a large number of users. When it is realised that wheat, for example, is produced generally by a very large number of small farmers in many parts of the world, and the resultant bread or flour is sold to the consumer through a large number of independent retail outlets, the magnitude of the organisation for bringing the producer and the consumer together should be readily visualised.

Specialised dealers

Hence arose a group of specialised merchants and dealers in these international commodities. The method of organisation and dealing varied with the goods in question. This largely depended upon whether or not the goods were homogeneous and could be easily graded and dealt with by sample and description. Each of the markets grew up naturally to satisfy a demand for an organisation to cope with the increasing trade in the various commodities. Just as the informal eighteenth century coffee house

meetings developed into Lloyd's for insurance and the meetings of the different bank clerks developed into the Bankers' Clearing House so did the concentration of dealers in different commodities lead to the establishment of recognised produce exchanges.

Metals

"The actual London Metal Exchange Company Limited was established in Lombard Court in the year 1877. Long before then a small body of merchants and merchant-bankers who carried on the business of shipping, financing and distributing metals, met informally in the Royal Exchange, later on at the Jerusalem Coffee House in Cowper Court, and still later on at the Lombard Exchange and News Room in Lombard Street. Finally the Metal Market and Exchange Company Ltd. was incorporated on the 30th July, 1881. The present Exchange building in Whittington Avenue was opened as a terminal market in 1882. It is interesting to remember that this locality has historic interest as the site of the Roman Forum where traders of ancient days gathered to transact their business.

"For some time before the market was formed, the need for facilities which it was ultimately to provide had become increasingly felt by producers, merchants and consumers alike. As mining became more and more industrialised and output increased, it became necessary for the producers to be able to sell their products whenever they wished, and in any quantity, and for any delivery whether nearby or far forward. Conversely consumers required similar facilities to enable them to ensure the purchase of a supply of their raw material. In such circumstances the merchants were ready to buy or sell as the situation required, and thereby maintain a balanced position between supply and demand.

"Moreover, all sides at that time felt the necessity for a daily list of quotations which would be recognised throughout the world as authoritative prices for standard articles. This could only be established by the operation of a free and open market."[1]

Corn and cotton

The Liverpool Corn Trade Association dealing with the

[1] J. D. Wolff, *The London Metal Exchange*, 1943.

growing trade in corn was developed from 1853; the London Corn Trade Association was formed in 1878 and incorporated in 1886. The Liverpool Cotton Association dates from 1882; and abroad the New York Produce Exchange was established in 1850 and incorporated in 1862 to deal with a variety of agricultural products. The Winnipeg Grain Exchange dates from 1887 with a new organisation from 1908; and other Exchanges for the handling of cotton, wheat, coffee, etc., have been established in different parts of the world.[1]

Methods of dealing

Business is normally conducted in two ways. There are the buyers' and sellers' Agents who contact each other for the immediate delivery of a commodity for what is known as "spot" transactions. The contract is for immediate delivery of recognised grades of the produce, or of produce which has been actually inspected or sampled, and this is no different from any ordinary purchase or sale. The great advantage of an exchange is that the principal buyers and sellers are able to make contact with each other and that a fair market price dependent upon the supply and the demand for the commodity can be fixed between the parties to the contract. Sellers know where they can dispose of their produce and buyers know where to apply to obtain the necessary supplies. This is the ordinary market mechanism and excites little comment. It is the extension of the dealings into the future which has given rise to criticism, much of it ill-informed.

Both buyers and sellers are not concerned only with the immediate present. They look to the future. A farmer or a dealer in grain is not only interested in the price of the commodity which he is selling at the moment. He is concerned with the price of the commodity which he is bringing to market or which he is acquiring with the object of bringing to market. With the development of the telegraph and cable, cotton importers began selling to spinners cotton which was not yet in the country. The contract was not for "spot" cotton but for cotton "to arrive" or "in transit".

Formerly grain importers who had a cargo on the way sold it in the best market. On arrival at the port of call the ship was

[1] J. G. Smith, *Organised Produce Markets*, pp. 30-5.

directed to the place of sale. Gradually, with the use of wireless, ships on voyage were redirected without calling at a prior port.[1]

From this method of dealing it was an easy step to the "Futures" market proper. Importers would contract to deliver at a later date a certain quantity of the product at a stipulated price. They would sell a commodity that they had not got at that moment in the belief that they would be able to get it by the time of delivery. Likewise, buyers agreed to buy for future delivery that certain quantity of the commodity at the stipulated price.

This type of dealing, where buyers are willing to accept the commodity in the future and where sellers are willing to make a contract to deliver in the future without being in actual possession of the commodity at the time, is only possible where buyers and sellers are numerous. The large number of dealers prevents the market being cornered. If there were few sellers they would often be unable to obtain the commodity to fulfil their contracts.

It can be seen that where users of the commodity are afraid that the market conditions are against them and that the commodity will rise in price they can find someone who will agree to provide them with what they want a certain number of months hence at a fixed price. Thus their worries as to the trend of prices are appeased. In the same way a dealer who believes that the price in the future will fall is able to offer to deliver that commodity in the future. He is confident in his ability to buy the commodity required to fill his contract at a lower price in the spot market when delivery is required by the buyer. If his judgment proves right he will make a profit by the fall in price. If he is wrong and prices rise it will cost him more to buy the spot commodity than the price he has received for his future contract. He therefore incurs a loss on the deal. He is backing his own judgment in the market.

"*Speculation*"

Hence arises the element of "speculation". The specialist dealers who are agreeing to accept or to deliver wheat or cotton at a specified price are "speculating" as to what the future price will be. This is just the same as a "speculative" builder who

[1] Smith, *op. cit.*, p. 10.

erects a house without a definite order is taking a risk as to the price he will get for it when it is completed. The factor who is purchasing the cotton crop for eventual shipment is speculating or gambling as to the price which he will get for the commodity when it is sold. He therefore covers himself, or "hedges," by selling "futures" at the current price equal to the quantity of cotton which he has bought. The grower gets the current price based on the price of the future.

It is this element of speculation which has principally attracted the attention of the critics largely because the price risk is borne neither by the grower of the commodity nor by the user. The risk is carried by a specialist operator who is pitting his skill and knowledge against the whole market. It is the specialisation of the function which makes it noticeable. But if the specialist operator is removed the element of speculation is not removed. The workman who bargains for his rate of wages is gambling as to the future purchasing power of the money wages which he has contracted to accept. If the value of money falls, so that his wages do not go as far as he expected that they would when he made his contract, he loses on the deal. The small shopkeeper who buys a commodity from a wholesaler is gambling on being able to sell it for a certain price. The dealers who attended the nut auction of the Ministry of Food were gambling as to the price which the public would be prepared to pay for their Christmas nuts and the gamble did not succeed.

Whereas everyone "speculates" to a greater or a lesser extent, the produce market where people specialise in the bearing of risks has attracted an undue share of criticism. Farmers who have sold wheat after the harvest and see, owing to circumstances over which they have no control and about which they have no knowledge, that the price has risen, are apt to blame the middleman and the speculator for the rise. If the price falls after they have sold so that they obtained the higher price then criticism is apt to be stilled. But the criticism is based on ignorance of the functions of the market. There are people in the market who provide the "utility of place" by transporting commodities from places where they are of low value to places where they are of higher value; there are others who provide the "utility of time" by holding stocks at a time when they are plentiful and therefore cheap with

the object of selling them when they are scarce and therefore more valuable. This criticism has led to certain action by governments.

The use of speculation

In particular, governments of predominatingly agricultural countries where the farmers' vote is of great political significance have been led to make various inquiries as to the activities of the "futures" markets, and as a result "the general body of accredited economic doctrine of this subject is remarkably composite and uniform."[1]

"It is the need of taking care of this element of price-risk that has made the marketing of such commodities as cotton and grain a business quite distinct from their production. By a process of division of labour, it has given rise to a new industrial class; the speculators or specialists in risks who are now organised in the produce markets. This risk-bearing class provides a continuous market ever ready to buy or to sell. These speculators thus meet the wants of producer and consumer, or farmer, elevator company, merchant or miller, who may want to pass on to other shoulders, by 'hedging' sales or purchases, the risk of loss arising from future fluctuation in the price of the commodity in which they deal."[2]

Marshall shows that the system of removing price worries from the farmer, miller, or shipper allows each to concentrate on his proper business, and lets the question of "prospect-judging" be performed by a specialist class who are able to make a particular study of the business, and that wide markets are necessary for the proper performance of the marketing function.[3]

The practice of the merchant etc. in hedging his dealings transfers the speculative element to someone else. It does not create the inherent speculative nature of any form of trading. If he does not hedge his transactions, he is commonly regarded as being extraordinarily reckless. Even where speculation in the strict sense of the term takes place in the market, where dealers sell short or buy long simply with a view to profiting from

[1] *Dominion of Canada Report of the Commission to Enquire into Trading in Grain Futures*, 1931, p 16. This is referred to as the "Stamp Report," from its chairman, Sir Josiah Stamp.

[2] Stamp Report, p. 16.

[3] Marshall, *Industry and Trade*, p. 252.

anticipated price movements and are not themselves moving grain, these dealers are still performing a useful service by providing a continuous market without which successful hedging would be impossible.[1]

As to the effect on prices, Sir Josiah Stamp pointed out that it is definitely the teaching of economists that the main service rendered by speculation is in the steadying of price, because after harvest when supplies are ample speculators buy for the future. This supports the market. The speculators sell later in the year when supplies are short. The supply is distributed more evenly over the year, so making for a steadier price than if all the supply were marketed after harvest.[2]

It was also claimed that the average price to the producer was raised through the use of the speculative market. The various agents who handle the primary products from the producer to the consumer are faced with various risks. But as they are able to hedge their prices, i.e. to make sure of a certain return, they are able to offer a better price for the commodity. One business risk is removed from them. Without the hedge the elevator company will cover its risk by offering a lower price to the farmer.[3]

The speculator only makes his money by being right. If he buys and keeps the commodity because he expects it to rise in price and that price, because of the long term market conditions, eventually goes down, then the speculator loses. In an active market with many buyers and sellers he cannot influence the long-term market. The price will depend on the supply and demand conditions of the commodity. The speculator who buys has to sell; the "bear" who sells believing that the price will fall will only profit by covering his sale at a lower price if the price really does fall. Either buyer or seller is backing on his powers of forecasting the market. He is "planning" in the broad sense, but he is "planning" with his own money.

It is contended that the multiplicity of dealings causes the short period hourly oscillations about the market price to be excessive, but the final summary of the Stamp Report states that "in addition to the benefits reflected to the producer in furnishing a system of insurance for the handling of his grain, and in providing an ever-ready and convenient means for marketing the same,

[1] Stamp Report, p. 18. [2] Ibid., p. 20. [3] Ibid., p. 21.

futures trading, even with its disadvantages of numerous minor price fluctuations, is of distinct benefit to the producer in the price which he receives."[1]

The gain to the buyer

The commodity exchanges do not only serve the purpose of the seller in finding a market for his product. They are places where the buyer can find the commodity he wants. Agricultural commodities in particular present special difficulties. To the layman wheat is wheat. The miller or the baker knows that there are wide varieties in the qualities of different wheats and that a type which is suitable for one purpose would be quite unsuitable for another. Cotton varies widely in its length and fineness and the cotton plant in different parts of the world will produce a commodity which is suitable for making a coarse cloth only or for making a cloth equivalent to silk in feel and texture.

These differences in quality are of special importance in British industry and nowhere of more importance than in the export trade. At the present time it is impossible for Britain to compete with countries more favourably placed or more richly endowed by nature on a basis of price alone. Britain cannot produce commodities of which the only appeal is one of cheapness of price. But Britain can produce goods that are unique in the world, goods whose appeal is quality of material and workmanship. These are goods which other countries either do not produce at all or which they can produce only at a greater price. Quality alone is not sufficient; it is the quality in reference to the price. Buyers are willing to pay more for the better article providing that the difference in quality is worth the extra price. It is not contended that high quality goods can be sold for any price whatsoever. The quality raises the goods into a different market but even so each market has its own supply and demand schedules.

Cotton

The early British cotton industry because of its first start in mechanisation was able to produce cheaper goods than other countries and largely concentrated on the export of "price" goods. Later there was the growth of the industry in newer

[1] Stamp Report, p. 72.

industrialised countries and the policy of protection of home industries in countries which had formerly been good customers for British goods. The cotton industry therefore turned its attention more and more to "quality" goods both in the home and the export markets. So the importance of the correct selection of raw material to combine with the workers' skill became of paramount importance.

The spinner who was fulfilling an order for a particular kind of yarn had to be certain that he could obtain the necessary cotton at the right time, in the right quality, and at a price which would enable him to cover his costs. For this purpose the Liverpool Cotton Exchange was the best in the world. Before the war the spot market maintained a stock at all times of about one million bales of every type of cotton in the world, whereas the terminal markets of the producing countries dealt only in the cotton which was produced locally. The spinner was able to inspect samples of his raw material for manufacture and had the whole world upon which to draw to fill his requirements.

It must also be remembered that cotton which is "graded" to be of a certain fineness and length will contain a variety of cottons all coming within that grade so that not all cotton bearing a certain "grade" will be suitable for a specific purpose. One of the functions of the merchants who operated in the market was to re-sort and grade and prepare samples of the cotton which had been imported so that spinners could obtain a material which exhibited little variation and ran evenly through the machines. The merchants went further than this and made up special qualities for special needs that would not be covered by the ordinary import types.

"Before the war, every facility a spinner required was efficiently met by the delicate and intricate machinery of the Liverpool and Manchester Cotton Associations. There were at all times enormous and varied stocks built up in Liverpool and Manchester by the cotton merchants, who had intimate knowledge of spinners' potential demands, and of the best markets and sources from which they could be fulfilled, and there was never any difficulty in getting the exact quality required for any particular trade. . . . With regard to cotton on the spot, the finest selection in the world was obtainable both in Liverpool and Manchester. It was housed

in warehouses ready for delivery on short notice and the spinner had the advantage of making his selection of the most suitable cotton for his requirements, frequently at prices below those of other centres."[1]

Flour

The importance of the right selection of the quality of the commodity can also be seen in the grain trade. "In the case of machine-produced breads, the baking procedure used cannot be altered to nearly so great an extent or so readily as in the case of hand methods of baking; consequently, the flour used must be more uniform in quality and of greater gluten strength in order to stand more mistreatment than formerly."[2] Even different parts of the country, owing to the prevalence of home baking, require different qualities of flour.

Wool

The marketing of wool differs from that of cotton. The normal method of disposal is by public auction, which attempts to centralise competition and to eliminate the effects of the personal influence of the bargaining power of individual buyers and sellers. Each single lot is treated as a different commodity and not as part of a standard grade as is the case with cotton. The reason for the difference in the method of marketing and the lack of "futures" trading in the commodity is due to the difficulties of standardising quantity and quality. The fleece contains a variety of different lengths and finenesses of wool, unlike the cotton plant which produces a more uniform product. A certain amount of future trading was done, however, in the next stage in wool production, that of the wool "tops," but before the war the dealings were of relative unimportance.[3]

The gain to the manufacturer

Dealings in "futures" also have their purpose in the using side of the industries. A manufacturer of cotton yarn who

[1] Memorandum submitted by the Federation of Master Cotton Spinners' Associations to the Board of Trade, 8th Nov., 1945.

[2] *Report of the Dominion of Canada Royal Grain Inquiry Commission*, 1938, p. 154. (The Turgeon Report.)

[3] Gerda Blau, *Wool in the World Economy*, pp. 38–9. (Royal Statistical Society.)

received an order to spin a large amount of cotton would cover himself against future movements in the price of the raw material. If his selling price was agreed with the buyer and the order was for a substantial quantity the spinner would not want to buy and store all his cotton at once. He may not have sufficient storage space. If, however, he made no arrangements to the contrary, he would find that if the price of cotton rose he would be buying the raw cotton required to fill his contract at a higher price than he had estimated when he made the contract to spin. With a well organised commodity market he can cover himself. He buys sufficient "futures", spaced out over the period when the cotton will be required in the mill, at the current price, confident that he can exact delivery at the due date. Therefore in agreeing his price with his customer he knows for certain the raw material cost and can estimate his working up expenses and concentrate upon his proper business of manufacture. Without the "future" contract the spinner would either have the expense of buying and storing all his requirements or have the prospect of facing a considerable business risk.

A spinner who wished to keep his machinery going, but had no definite order to work to, made use of the "futures" market. He protected himself by buying cotton to spin and at the same time sold "futures" as a hedge. He could base the selling price of the yarn produced on the ruling price of "futures." When the yarn was sold, he bought back the "futures." Merchants and spinners could work on a low margin of profit because one important business risk was eliminated. British import merchants of cotton were content with an average margin of 1 per cent.

Hedging against price fluctuations is quite usual in the corn trade where importers hedge their purchases while stocks are still in their hands and millers hedge grain against the flour they are milling.

Metals

Similarly in the metal trade, the producer and the smelter hedge their purchases. A manufacturer of electrical equipment, who has obtained a contract extending over a considerable number of years, and who wishes to be sure of his costs for copper, etc., can buy "futures" on the Exchange and then estimate more

closely the price he is to tender for the contract. The difference between the former hedging market and the present is seen from the following: "How can a manufacturer, working on an allocation of solid fuel about which he has no reason whatever to feel any confidence, depending on an allocation of steel from a government department or agency, and having no means of hedging on the markets for his requirements of copper or lead, be expected to quote for an uncovered risk of two or three years?"[1]

Invisible exports: (a) *metals*

The pre-war normal commodity market, in addition to providing a means whereby buyers and sellers could transact their business at the world price, has also a special importance for Great Britain. Being the centre of the world trade in many commodities, and because of the recognised method of dealing and the high reputation enjoyed by the different exchanges, other countries used the services of the exchanges in this country.

In the metal trade, "this practice of hedging enabled the merchants not only to import and distribute to consumers in the United Kingdom, but to increase the country's growing international trade. They thereby contributed materially to the invisible exports, on the existence of which this country's prestige and wealth in the past 200 years has so greatly depended, and must, in even greater measure, depend when the present war is over.

"A resultant of the international trade transacted by the merchants of the United Kingdom was the attraction to and accumulation in the country of large stocks of commodities; these include metals, which were shipped, warehoused, and financed by members of the Exchange. The benefits arising from these services were naturally shared by shipping, banking, insurance, lighterage, and warehousing interests.

"The services of the Exchange have not been confined solely to the purchase and sale of metals and to the daily fixing of prices. Great use has been made in other countries as well as in the United Kingdom of its Arbitration Rules, which have been an integral part of many thousands of contracts, not only for copper,

[1] Rt. Hon. Oliver Lyttelton, *Hansard*, 26th June, 1947.

tin, lead, and zinc, but for ores, scrap, and semi-finished products and for metals not officially quoted on the Exchange."[1]

(b) *Wheat*

"In the course of a year many transactions embracing huge quantities of wheat and other grains which never touched the shores of this country were completed in the United Kingdom. Each transaction created a chain of profitable business. Let us take as an example the sale of a cargo of Argentine wheat to a distributive merchant in Rotterdam. Apart from the fact that the firm doing the business would expect to earn a commission or profit, although that was not always the case, each trade brought business to chartering agents, shipbrokers, shipowners, with the many ancillary transactions that a ship voyage leads to; the insurance broker, the underwriter, the exchange broker or bank on exchange cover; superintendents, checking the outturn, etc., and the cable companies; whilst the government benefited by bill stamps, policy stamps, telephone calls, and telegrams, to say nothing of the contribution to the Exchequer. In addition, possibly a hedging order would be given to a firm in Liverpool by the Rotterdam merchant to hedge the unsold balance.

"It is perhaps not generally known that the contract of the London Corn Trade Association was used not only for business to destinations outside the United Kingdom originating in the United Kingdom, but for a very large portion of the transactions in overseas wheat and other cereals as between two individuals or firms on the Continent and even in more distant lands. The contracts were in fact published in several languages.

"This proof that the United Kingdom was the centre of the International Grain Trade also bears testimony to the high regard in which the London Contract was held by all members of the Grain Trade wherever domiciled. All arbitrations on the London form were of course held in London, whilst there were other fees attaching to analysis and to the ascertainment of natural weight and other services. These and all the foregoing were valuable invisible exports."[2]

[1] J. D. Wolff, *op. cit.*, pp. 7–8.
[2] Memorandum of the Corn Trade Association, 1944, pp 22–3.

(c) *Cotton*

The high reputation of the merchant and the value of the recognised method of dealing is to be found equally in the cotton industry. The prestige of the Liverpool Market was so great that the various standard forms of contract issued by its Association were in general use throughout the world. The contracts provided for arbitration in Liverpool by Members of the Association and such arbitration brought in a regular contribution of foreign exchange in arbitration fees. Even when the actual forms of contract were not used, other contracts frequently provided for arbitration in Liverpool. Merchants also earned foreign exchange by shipping cotton to other countries, either direct from the country of origin or as re-exports from this country.[1]

Britain was also the centre of the world trade in many other commodities such as tea and wool, and much of what has been quoted above applies to these trades. Britain, the great consuming and merchanting country, has attracted to it a valuable trade, which uses up no scarce natural resources, but which has depended upon the business methods crystallised through the associations of merchants.

Commodity prices

It must be remembered that in no cases do the commodity exchanges fix the prices of the commodities which are the subject of the dealings. Ultimately, the price reached measures the forces of the supply and the demand for the commodity. The market is only the place where these forces act and react upon each other. The Stock Exchange is the place where the buyers and sellers of stocks and shares may meet and transact their bargains. The prices reached do not reflect the individual or the collective opinion of the members or the Council upon the value of the stocks handled. That value is determined by the general public showing their opinion by buying or selling. The recorded dealings register what is in the mind of the public.

The prices of the commodities in the world markets are a reflection and a consolidation of the conditions existing in the world for the different commodities. If there is a good grain

[1] Memorandum of the Liverpool and Manchester Cotton Association, 1945, p. 7.

harvest there is a plentiful supply on the market; sellers are more anxious to dispose of their crop; buyers know that there is plenty, hence the price falls. The price falls because now the grain is relatively less valuable than other goods that compete for the consumer's money.

Between the two wars the prices of many commodities on the exchanges exhibited great variations, in the same way as the mercury in the thermometer exhibits great variations between the high level of a warm summer and the low reading of an exceptionally cold winter. One does not blame the mercury for the cold weather and the burst water pipes, but many people have blamed the exchanges for the underlying fluctuations which the latter only record and do not control.

The fluctuations which took place were partly the outcome of normal trading conditions, the niggardliness or the bounty of nature in agricultural crops and changes in consumer habits from one commodity to another, and were a means of recording and correcting the economy where necessary. Where the fluctuations were abnormal the underlying cause was generally political. As should now be realised the effect of the war of 1914–18 was to disrupt the trade of a great part of the world. The consequent readjustment took time. Further, the many attempts of different governments to shield their citizens from the consequences of the necessary changes did much to disrupt the international trade in many world commodities. The growth of tariffs, the bounties on exports or on home production, restriction schemes, quotas, competitive exchange depreciation, the threat of war, the preparations for further wars, all made trading conditions difficult. The wonder is not that the patient was ill but that he did not die from the attempts to revive him. It must also be remembered that the quoted prices are in terms of currencies the values of which most governments proved incapable of keeping steady. Yet currency control and management is a proper and necessary function of government. In fact there were times when wheat was bought as a hedge against the depreciation of the currency. It follows that much of the excessive variations in commodity prices must be discounted as we are measuring a fluctuating commodity against a fluctuating money.

Long-term changes

Neither is the market to blame for the operation of long-term tendencies that cause the rise of one industry and the decline of another. The inter-war troubles of the cotton industry in this country were due to the protection of the manufacturing industries in other countries, the development of Japanese competition based on low costs ("rice standard" wages), the protectionism of the British government reacting on the export trade, and the general political difficulties of all forms of international trading. Yet it is seriously suggested that "I do not attribute the disaster which overtook so many workers in the Lancashire cotton industry *entirely* to the operations of the Liverpool Cotton Market." (my italics.)[1]

The main attempts at intervention with the normal flow of commodities in international trade have come from the producing side. As has been shown in Chapter VI various governments of the countries producing the primary commodities have controlled the market. There the object has been to raise the price at the expense of the importing countries. Little had been done on the side of the consuming countries. Since the outbreak of the Second World War and the peacetime conditions following the war government interference has been greatly extended. One of the principal methods of controlling prices is for the government itself to enter the market, either in competition with the existing trade organisations, or by taking over the whole function of buying and selling the commodities. Government bulk purchasing, or centralised buying, is price control par excellence. It is that aspect of price control which will be the subject of the next chapter.

[1] *See* debate on the Cotton (Centralised Buying) Bill, *Hansard*, 2nd December, 1946, col. 116.

CHAPTER XI

BULK BUYING

THE term bulk buying can have a variety of meanings, but the definition used here is that it is the centralised buying of commodities by a government, for eventual re-sale to other people. Where a government is the sole user of a commodity, such as warships, the term bulk buying in the above sense is not applicable, as all its methods of procurement, whether by itself manufacturing the product or by obtaining the product from contractors, etc., are only alternative methods of obtaining the supply. "Bulk" is not used in the sense of a large order. In common usage the word means that all the supply of the commodity passes through the hands of a government, or of some agent acting on the government's behalf. And it means that the commodity passes through to other users. The government does not buy because it wants the commodity for its own use, but for eventual resale to other users, either manufacturers, wholesalers, etc., or the ultimate consumers.

State trading

We are not concerned here with State trading as such. Where the government provides a commodity, as in the tobacco monopoly of some countries, or the services of transport, other considerations apply. Here the government is going into the manufacturing and the retailing business and performing all the functions right the way down to the consumer. If, for example, cotton manufacture became a government monopoly, it would raise different problems for discussion from those considered here. Where the government merely interposes itself somewhere in the long line extending from the independent wheat farmer through the miller and the baker to the consumer of bread, so that at one stage of distribution the commodity passes through government hands, the problem is different from that of government manufacture. It might be more correct to call it government wholesaling and control of a commodity, but the term bulk purchasing is now so well known that it will be used here to cover the abovementioned wholesaling and control.

Buying for consumers

The emphasis is placed on the aspect of buying for re-sale to others, i.e. the government buys to obtain the commodities usually for its own citizens; it is acting as the agent for the consumer. Governments have engaged in trading activities, such as those discussed in Chapter VI, where they have bought all of a particular commodity, but there the emphasis was that they were acting as the agents for the sellers of the commodity. Of course government buying (unless the commodity is to be used by the government alone) necessarily involves government selling. The two go together. But in the former case the object is to act in the sellers' or producers' interests, in the latter the object is to act in the interests of the consumers. The former is better known, the latter is a more recent development, especially when it is on a large scale.

While in the majority of cases the government seller is selling abroad the products of its own citizens, the government buyer is buying from other countries commodities to be used by its own citizens. Although sometimes the commodity may be manufactured into something else for re-sale abroad.

War-time beginnings

Government bulk-buying in Britain was developed during the war of 1939–45. Normal consumer's choice had to be subordinated to the purpose of winning the war. Supplies of scarce materials had to be diverted to war ends. There was a need to conserve shipping space and to observe secrecy in ship movements. There were the difficulties in the financing of overseas purchases, as well as the internal financial position, so the government took control of the purchase and production of a great majority of commodities. Individual ends were replaced by collective ends, and the fact that the system was generally accepted was evidence that the majority of the citizens approved the purposes for which it was undertaken. But the system has been carried on into peace-time.

The reasons advanced come under two heads. One is that although the war is now over "normal" conditions are not yet restored. There is a "transition" period between the normal of

pre-war, upset by the war itself, and the normal of post-war, which is yet to come. In this transition period semi-war-time measures are still necessary. The other group of arguments is based on specific advantages which are expected to accrue from bulk purchasing, that it is more efficient than normal trading methods, and hence should be applied even in the normal post-war period. One is a temporary expedient, the other is a permanent institution of the economy. In the practical applications it is sometimes difficult to separate these two methods of approach.

While the position is constantly changing, some commodities are being released from government purchase and control and others are at times being added to the list, the following are the principal items of food and commodities of which the government announced that it was the sole importers in June, 1947:[1] cereals and flour, sugar, oils and fats, bacon and ham, carcass meat, dried egg, butter and cheese, processed milk, starch, tea, coffee and cocoa, most dried fruits, animal feeding stuffs, canned fruit and tomatoes, citrus fruits, eating apples and bananas, rice, canned fish, ware potatoes, most timbers, cotton, flax and jute, hemps, building boards, wood pulp, pulpwood, esparto grass, skins, sulphur, molasses, various acids and oils, chrome ore, lead, zinc, copper, virgin aluminium, pig iron and steel.

The following metals and ores have been released for private importation, subject to government licence: aluminium scrap, bauxite, manganese, silicon, zinc concentrates, and other semi-rare metals.[2]

Among raw materials that have been transferred from the Board of Trade to private account are: certain types of timber, wool, silk (except from Japan), coir and kapok, certain wood-pulps, papers, certain classes of leather, rubber, etc., but it should be noted that ultimate control over purchase is retained by the government by the import licensing procedure.[3]

All raw materials and commodities controlled by the Board of Trade are published in the *Raw Materials Guide*. The edition of November, 1946 covers 86 pages!

[1] *Hansard*, 24th, June, 1947, col. 30–1.
[2] *Hansard*, 30th, June, 1947, col. 121.
[3] *Hansard*, 1st July, 1947, col. 1150.

Monopoly buying

Where the government is the sole buyer of a commodity it is in the position of a monopoly buyer (it is a "monopsonist" of the commodity). Although much has been written of the theory and the practice of monopoly selling, economists have written little on the subject of monopsony, either in the theory or the practice. Monopoly has been the more usual problem; it is to be hoped that attention will be turned to working out the theoretical implications of the other group of problems. Monopoly buying is the rarer phenomenon because it is more difficult to achieve. Even when a government makes itself the sole buyer of the commodity for its own country and so acts as a monopoly seller to people within that country, or to the foreign customers of the country, it is not necessarily the sole buyer of the commodity on the world market. The government purchases all the cotton requirements of Britain, but although it is a considerable force in the world market it by no means has control over the total world output. It is a large buyer but it certainly is not a monopsonist.

Where the commodity is produced and sold within a country only and the government or a government sponsored body is the sole seller, then the government may be in a monopoly position for the purchase of raw materials or labour, whose sole outlet is to the government. The Coal Board is the sole buyer of mining labour, although it is buying in competition with other demands for similar labour and is therefore not able to exercise a very strong monopoly power. Where, however, the labour is particularly specialised to that industry and can earn higher returns there than in some alternative employment, as with, say, colliery managers or other specialists, the Board is in a very strong buying position. Similarly the B.B.C. is the sole buyer of broadcast material in this country and is in a position to fix the rates. The price fixed is believed to be lower than would result if there were competitive buying of broadcasting material. *See* the correspondence columns of the *Author* passim.)

Advantages claimed

The principal advantages claimed for the government bulk

purchase of commodities are stability of price, the economies of large-scale purchase, economy in manpower in purchasing, the guarantee of the market for the producer and of supplies to the consumer, and perhaps, in some quarters, the fact that there is government control over materials and foodstuffs means that there is ultimate government control over the distribution and the consumption of various commodities.

"The method of the single buyer using the stock as a buffer is cheaper in manpower and gives, I think, longer periods of price stability. In the long run we have an economically run Commission, employing 250 people, which will give us cheaper cotton than a free market of more than 3,000 people. That is the basic reason why one must be cheaper than the other; it will take fewer people to run the service."[1]

"But the greatest gains for the industry will be stability of price, the economies of large-scale purchase, and the scientific matching of the needs of individual spinners to the supply of scientifically selected appropriate grades of cotton from all over the world."[2]

"To-day we are proposing to make permanently available to the industry the modern method of centralised and large-scale buying. It is the technique which lies at the root of the success and growth of the multiple stores, the multiple tailors and the great Co-operative movement."[3]

"For the great majority of essential foods bulk purchase is the only practicable method to secure the maximum quantities available from abroad and their equitable distribution in this country."[4]

The method of the long-term contract for supplies is also defended by the claim that it ensures that the supplies are available for the country at a cheap price. It will be necessary to consider these points in detail.

Numbers employed

There is force in the argument that if the business can be

[1] Mr. Marquand, *Hansard*, 18th April, 1947.

[2] Mr. Marquand, 3rd May, 1946, quoted in *A Warning to the Taxpayer*, issued by the Liverpool Cotton Association.

[3] Mr. Marquand, *Hansard*, 2nd December, 1946.

[4] Dr Summerskill, *Hansard*, 23rd June, 1947.

operated by fewer people, then it can be undertaken at a lower cost than if it is operated by a larger number of people in the market. *If the same service* is provided by 250 people as was formerly provided by 3,000, then there is a saving in manpower to the country of 2,500 people. As the industry is not burdened with their wages and profits the commodity comes cheaper to market. The argument is valid only if the same service is being provided. It costs more to distribute goods to the consumer's door than to sell them over the counter, the service is different in the two cases. As to the quality of the service provided, the Federation of Master Cotton Spinners' Associations, as a result of the war-time control of cotton, states that, "We have no opportunity of choosing the cotton we desire and are not permitted to see the type of cotton or the quality offered. It is not even sampled prior to delivery, and there is no one to examine the bales which are to be delivered so as to compare style and staple as was the case when the Liverpool and Manchester Cotton Associations functioned in the ordinary way. Quality and consistency as compared with pre-war have deteriorated, and many firms have been put to endless trouble in changing their machine settings (with delay in production and increased costs) to meet the different varieties of cotton which they have been compelled to use, under the direction of the Control. We have to use the cotton given to us and selection of types and qualities no longer exists."[1]

This recalls to mind the experience with the Coal Board, the bulk producer of coal, and the former Minister of Fuel (Mr. Shinwell), who told how often he received small parcels addressed to him at the Ministry, only to find on opening them that they contained pieces of slate and other foreign bodies which the senders complained had been delivered to them as coal.

Export employment

There is another question with regard to the facilities offered. As has been pointed out in the previous chapter, the Liverpool Cotton Exchange was an international market rendering services to people outside this country. If the excess of people compared

[1] Memorandum, *op. cit.*, p. 34. *See also* the annual reports of large cotton firms, such as J. P. Coats, for complaints regarding the quality and price of cotton.

with the present system, 3,000 less the 250 of the Commission, were *all* concerned with earning invisible exports, which have been admitted to be £1 million, this would give an average of £364 each; if the work of 1,000 only is attributable to earning foreign exchange that would give a figure of £1,000 per head. Many of the people employed in those of our commodity markets which enjoy an international reputation are engaged in international trade. Consequently their numbers are not to be counted as part of the manpower necessary for the domestic trade.

Large stores

Bulk purchase of raw materials is not to be compared with the buying policies of the large multiple stores, multiple tailors and the Co-operative movement. It would be difficult to maintain that the success of these business ventures has been due solely to a method of buying. The customer has a free choice and can patronise these different types of stores or patronise other methods of retailing. Whatever business methods are adopted by these concerns, and they will vary with different circumstances, the firms are not committed to any one buying policy. They are in active competition with other people in the trade, and if they are unsuccessful they go under. It is the firms which have been most tied to one source of supply during the war which have experienced the greatest difficulties due to war-time shortages, being outlets for commodities which are rationed; the departmental stores, which are less tied, have been able to weather the war-time difficulties by switching to other sources of supplies. Even the Co-operative stores are not tied to the Co-operative Wholesale Society, they buy from that or other sources as they wish. It is a complaint in the movement that the local societies do not patronise enough the goods obtained from the Wholesale Society. They do not because they buy what the local customers want.

The success of the undertakings quoted is obtained on the side of selling. They provide the goods the customer wants in competition with the goods he can buy in other shops. Mere bulk buying would not lead to their undoubted success. As is well known, many of the most successful large-scale retailers refuse to take the whole output of a factory although they could

easily sell it all, because of a refusal to be tied to one source of supply and because they do not believe that the factory should have to rely on one sole outlet for their product.

Lack of competition

But the crux of the difference is this. Whatever method of buying is used, and buying is only one aspect of business acumen, the firms are in competition. It has been asked by Mr. Errol, "If this Cotton Commission is to be so very good, if it is really going to be all that it is made out to be, why is it necessary to prevent so many merchants from setting up in business in competition with the Commission? Why is the Bill littered with penal clauses? Why should there be so many penalties for doing things which should not harm or injure the Commission? If the Commission is able to do things so much better than the private merchants, surely no private profiteer would think of entering the field."[1] The answer is to be found in Pigou, where it is stated that, "When any enterprise is operated by a public authority it is likely to be maintained by artificial support, even though it is less efficient than its rivals. . . . Hence a government authority embarked on a business is almost certain, if it prove commercially weak, to employ unfair methods from its non-commercial armoury, the use of which will maintain it more or less permanently in being, despite the fact that its productive methods are more costly than those of its rivals."[2]

Price stability

Bulk buying can certainly introduce an element of stability into the price. There are two main aspects to price fluctuations, there is the short and the long period fluctuation. A government buying all a commodity and fixing its selling price to the manufacturer under monopoly selling conditions, can keep its price fixed indefinitely. It need never change, irrespective of the financial result, because behind the government there is always the security of the taxpayer. But it is not contended the prices will be held at the same level irrespective of the conditions of supply and demand affecting the commodities; prices will change—the question is how often they will change. If, for example, the world price of copper falls by £12 within a year

[1] *Hansard*, 2nd December, 1946, col. 96. [2] Pigou, *Economics of Welfare*, p. 392.

the change can be made by lowering the price £1 a month, or by having a stable price throughout the year and lowering the price at one go. There is the same element of price change. In the first case dealers get gradual warnings from month to month; in the second case they get a sudden sharp shock. The idea that there can be stability in an absolute sense is a sheer mirage. Stability could be obtained only if the government could guarantee the absolute harvest of an agricultural crop and could

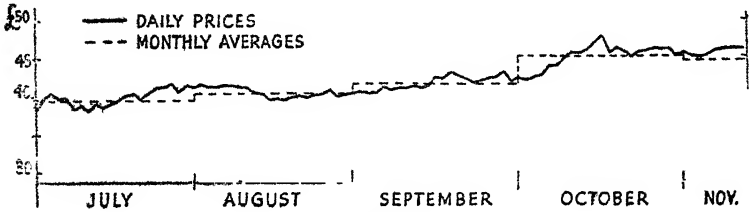

Diagram 8

Copper prices 1938

Note how in a period of rising prices movements are gradual Dealers have ample warning. Compare the abrupt changes in post war years.

guarantee that the consumers would never alter in any way their desire for the commodity.

Price changes represent the changing conditions of demand and supply on the market. Although the money price may be fixed for a time the ultimate realities of the situation will make themselves felt. Fixity of price has been tried and failed on the supply side; it will equally fail, if it is seriously tried, on the demand side. As a government therefore cannot succeed in keeping the long period price constant unless it controls nature (which might be advisable), and also controls the consumer not only in what he may *not* have, but also in what he *must* buy (which might be considered less advisable), there must be changes in the prices of different commodities.

If prices change in the short period this is a representation of the day-to-day changes in circumstances. Because the weather reports are good in the spring there is the anticipation of a good wheat harvest. There is not the same urgency to buy, so the price eases off. The market gets prior warning that wheat might be more plentiful and adapts itself accordingly. If, on the other

hand, there is a bad report of conditions the price rises. This is a signal to buyers and to consumers that supplies might be scarce and therefore they should *economise*. It is more than that. It is a signal to producers in other parts of the world, whose

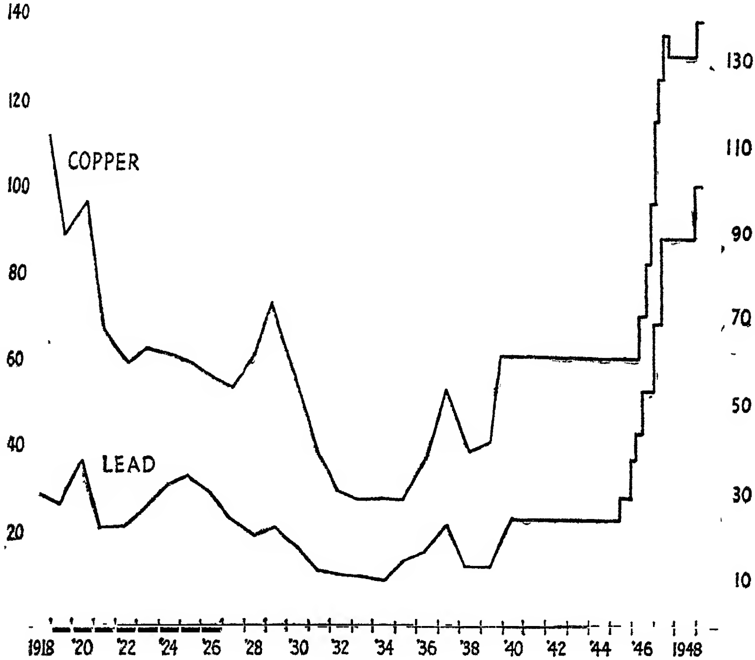

Diagram 9.

Changes in copper and lead prices in pounds per ton.
1918–1939 average annual prices.
1939 onwards; official selling prices.
Prices before the war fluctuated with trade activity. During the war they were officially "pegged." In the post war period there has been a greater degree of fluctuation with very violent daily changes.

seed time and harvest, owing to the vagaries of nature and the facts of geography, do not happen to coincide with those of the times of the country with the expected bad harvest, that as wheat is likely to be short it will be profitable for them to plant a bit extra, thus rectifying the shortage in the first area. Where the price fluctuations are delayed, reactions to the fluctuations

are also delayed. Both producers and consumers cannot adapt themselves so quickly to the changes in their circumstances.

So while it is true that a government purchaser and seller can keep the price steady for a time, this steadiness is only at the expense of delaying the necessary reaction which should be brought into play. This reaction is required to counteract the real causes which engendered the change in price; but when the government does change its price the effect on the market is all the greater shock.

This sudden change of price can be more upsetting to a market than a succession of smaller changes which do show which way the wind is blowing before the hurricane sweeps one off one's feet. This is especially true where it is impossible to hedge the purchases. An interesting example was to be seen in the metal market in January, 1948. The price of zinc had been rising in the United States, and it was expected that the Ministry of Supply would adjust its prices to the world price. Zinc had been held at £70 a ton since January, 1947, but much resentment and adverse criticism was aroused in the market by the arbitrary manner in which the Ministry announced that no more licences to acquire zinc would be issued pending the revision of the statutory prices. The market was faced with complete bewilderment and uncertainty.[1] Business in many sections of the metal trade was at a standstill while the Ministry decided what was to be the new price. As it happened the new price, £75, was less than the market had been led to expect after the alarums and excursions. Apparently this is an improvement on previous methods of dealing. When the Ministry withdrew from the lead market in 1945 there was a gap of nearly four weeks in price quotations.[2]

The world price level

The long period price will depend upon the long-term conditions of the market. If a bulk buyer buys at the world price, how is it possible to obtain supplies at a price below the ordinary market price? When contracts are negotiated with foreign merchants or governments the parties to the contract will always have their mind on the price ruling at the time. If sellers can obtain a certain price for their product on the open market why

[1] *Metal Industry*, 30th January, 1948. [2] Ibid., 4th February, 1948.

should they sell to the British government at a less price? The only reason can be because of "their two bright eyes," but reasons of sentiment enter little into international trade. (Some of the contracts made with the Dominion governments have been at particularly favourable prices; one can therefore allow a considerable discount on the world price for sentimental reasons, as in the nature of a gift or grant in aid to the Mother Country after the war. We must attribute any of these low prices to generosity rather than to buying acumen, and we can no more expect a permanent continuation of this policy than we can expect food parcels to make a permanent contribution to our overseas balance of payments. While generosity may be good for the giver it is sometimes apt to have unfortunate consequences for the receiver.)

The idea that the single buyer can buy cheaper *from a large number of individual suppliers* must be based on the presumption that the single buyer, with his large order, can influence the market, that owing to his importance sellers will listen to his terms. If Britain were the sole user of a commodity produced by a variety of countries Britain could play one off against the other and obtain lower prices. But if these commodities exist they are very few. Britain is not the only market. And if she does not buy, sellers are quite prepared to take their goods elsewhere, especially if they can get dollars for them. In cotton, for example, Britain takes about two million bales out of a world crop of about twenty-five million bales, and so she is unable to control the world price. As has been pointed out by Mr. G. D. A. MacDougall, a large part of our trade is done with countries which are not dependent on our market, or which are more dependent on the United States, and these countries include Canada, South Africa and Malaya. Any attempt to drive our suppliers or to try to impose conditions on them will drive them into the United States market.[1]

A single buyer of a world commodity must pay the world price and will be holding the stocks at that price. On a rising market the value of stocks appreciates. The single seller can either adjust his prices to the world prices as they rise, in which case there is the same fluctuation in price as is to be found in

[1] *Economic Journal*, March, 1946 and March, 1947.

the ordinary commodity markets, or he may hold his selling price firm. In this case he is passing on the profit made on the appreciation of prices. This is no different from a manufacturer who lays in a good stock and is fortunate to find that its value has risen. The ordinary market would provide the manufacturer with exactly the same service, except that the gradual rise in the price of "futures" would give him a warning, and he would therefore have an inducement to lay in stocks.

When the world price falls the single seller finds that he is losing on the market value of his stock. If he adjusts to cover his loss there is the same price fluctuation either in small or large doses. If he does not adjust then he is selling the commodity to his own manufacturers at above the world price, and they will be handicapped in the export trade. If there is a sudden and heavy fall in prices the loss on stock depreciation must fall either on the industry or on the taxpayer—it must settle somewhere. Similarly, if the government is to provide at below the market price during a period of rising prices it can only do so by subsidies out of general taxation.

It may be expected that the profits on the price rise will compensate for the losses when prices fall, and that over a period the pluses and minuses will cancel each other out. In that case this will be no different from the ordinary market mechanism, providing that in the long run price falls, multiplied by the quantity of stock held, are equal to the price rises, multiplied by the quantity of stock which rises in price. That is assuming that the long-term fluctuations in price are of an even character, deviating regularly up and down in a regular cyclical movement from some assumed normal price. This ignores the question of the long period trend in prices which may be up or down, and this trend will be superimposed on the regular cyclical changes. No one knows whether a particular price fall is caused by a short period change in conditions, a long period fluctuation in the trade cycle, or some permanent change in the supply or the demand conditions of the commodity. A fall in the price of wheat at any moment may be due to a good harvest in some part of the world or to the regular downward movement of the trade cycle, or to the fact that consumers are changing over permanently to some other foodstuff, or to new areas of

supply bringing the commodity to the market at a lower cost.

A single holder of stocks will face all these eventualities, and instead of the element of speculation being eliminated, the speculation as to the future course of prices is transferred to the one body. Because individual speculation is canalised through one central channel it is not obliterated.

Long-term contracts

One method by which it is claimed the government can buy at below the world price is the long-term contract. "I believe that the real case for bulk buying is that it enables us to use the instrument of the long-term contract, which is far the best instrument at our disposal for increasing the amount of food which we can buy in the world."[1]

Long-term contracts for food have been made with a number of foreign, Dominion and Colonial governments, and different principles are to be found in the various contracts. It is to be noticed that often the price does not remain fixed for the duration of the contract. While some of the contracts have no review clause, others are to be negotiated annually, or to be reviewed if there is any significant change in costs. Quite obviously if at the time when contract prices are reviewed or re-negotiated there has been a change in the world conditions, giving a change in the world price, this will be reflected in the new terms to be agreed. So while there is the long period contract for a certain or a fluctuating supply, it is not a contract in the sense that the price is a firm element in the conditions. So stability of price over time is *not* one of the advantages of long-term contract.

If during the period that the contract is running the world price has meanwhile fallen, there has been a loss on the contract; if during the same period the world price has risen, there will be a profit on the contract. It is therefore a normal business transaction. Long-term contracts like these were quite common before the war, as can be seen in the tea trade. Instead of dealing with the normal tea auction some buyers made annual contracts with certain growers. Some would foresee wisely, while some would make bad bargains. One would expect the good and the bad to cancel each other. Some firms would expand their business, whereas others would be eliminated by the bankruptcy procedure

[1] *Hansard,* 1st July, 1947, Mr. Strachey.

as a penalty of failure. But when a sole buyer makes all the contracts he may make a succession of good or bad bargains without any compensating other contracts to offset any errors that he makes. The possibility of error is not eliminated; it is concentrated into one organisation. Decisions have been taken by people controlling the monopoly selling of agricultural products which have in the light of later circumstances turned out to be disastrous. There is no reason to suppose that monopoly buyers are free from human failings.

Critics of bulk purchasing are often asked if their objection is that the prices agreed are too high or too low, because whatever be the criticism examples can be produced to prove the opposite. Both criticisms, instead of cancelling each other out, are perfectly valid.

The one true price is the market price at which buyers are willing to take what they want, and sellers are willing to produce the same quantity. At that price supply and demand are equal. There is no inducement for anyone to change because both parties to the contract are satisfied at that price.

Price too high

If the price is too high consumers in this country are being forced to pay more for the commodities than is necessary, either in the price of the commodity or in taxation to keep the cost to the consumer down to a reasonable level. The longer the terms of the contract the worse is the position.

Price too low

Where the price is too low there is an apparent advantage. Costs of supply are lowered in the short period. But in the long period the results are not so advantageous. The low price offered discourages producers from expanding supplies. When it is stated that the reason for the existing high prices is the world shortage of certain commodities, the only cure is increased world supplies, and the sooner the better. The longer that low prices are obtained by producers the longer will the shortage in supply continue. An immediate short-term advantage will prove to be a long-term disadvantage.

One of the reasons advanced for the quick running out of the American loan has been that the price of commodities has

risen. One reason for the rise is the continued shortage of supplies; another may be that the large-scale buying of commodities on long-term credit, financed by loans, has added to the effective demand and so forced up the price. When, instead of world producers sending their goods to the British international commodity markets, emissaries of the British government go after the supplier, the terms of trade are bound to turn against us.

Bulk selling

There is a further reason why supplies are not forthcoming. The advantage of bulk buying is that the monopoly buyer is able to confront individual sellers with a take it or leave it ultimatum. Where that occurs within the area of the government making the contracts all is relatively easy, although even there supplies are apt to be disappointing. Where that occurs with the citizens of other countries no overseas government is going to stand aside and see its own primary producers faced with a government monopoly. Bulk buying leads to bulk selling. The contract is not made with the individual merchant or the farmer but with another government. Economically, where there are conditions of bilateral monopoly, the price reached is theoretically indeterminate. There is wide latitude to the prices which may be claimed or offered by either party. The price will depend upon the bargaining power or the sticking point of either party. If the seller is anxious to get rid of a crop which would otherwise be difficult to sell and the seller solicits the buyer, the price will approach the lower limit. If the buyer is anxious to make the purchase and seeks out the seller, especially when the buyer comes from a country which was formerly the centre of the trade in the commodities under discussion, the seller will obtain his price.

Prices rise against us because we are dealing with a monopolist who is selling all his commodity. The buyer is not obtaining small parcels from different suppliers who are prepared to accept a lower price. The one seller is able to stick for the higher price.

The evil is aggravated where the government seller uses the contract as a source of revenue. While it is difficult to obtain the figures, the government often preferring to keep them secret, in a number of cases the high prices paid are not received

by the producers, as a part of the proceeds is retained by the government seller. Two examples will suffice. "The International Food Mission recently concluded an agreement with the Argentine government for the purchase of linseed oil and a number of other vegetable oils. Just prior to the arrival of the Mission the Argentine government cancelled all export licences for these oils issued to private traders. It then faced the Mission as a bulk seller. The total profit made by the Argentine government, the difference between the prices paid by the Argentine government to its own nationals and the prices paid by the Mission, was thus 172.6 million pesos, say £12,760,000. And following the deal the controlled price of linseed oil in this country was raised from £65 to £135 per ton."[1]

"With Ceylon the Ministry of Food has a five-year contract (for copra) with about three and a half years still to run. The price is £32 a ton. But the Ceylon government has recently imposed a £15 per ton export duty, which the British are paying."[2]

Bulk buying from a bulk seller, where the seller does not pass on all the price received to the actual producers, means that everything happens for the worst in the worst of all possible worlds. Industries in Britain are handicapped with high costs, whereas the foreign producer is discouraged from producing because of the low price.

Future supplies

Neither bulk buying nor the device of the long-term contract is a guarantee of supplies. A contract for a future "export surplus" or "a fixed annual quantity" does not guarantee that the supplies will be there. Nature recognises no contracts. If there is no exportable surplus there is no export. It has also been submitted that although in the case of Dominion contracts no one would suggest that these contracts would not be honoured, certain other countries do not follow the same commercial code. Whereas it would be a breach of contract for a private individual not to fulfil his side of the bargain, governments are free to "denounce" agreements when it suits them. A vague understanding with one might be of fundamentally greater value than

[1] British Federation of Commodity and Allied Trade Associations. *Report*, No. 7, December, 1946.

[2] Ibid., *Report*, No. 8, April, 1947.

a watertight contract with another. It is not suggested that the government is unaware of these points, but the impression may be formed in the country that future supplies are assured.

Bulk contracts must be made for large supplies and a government cannot make thousands of individual contracts. "Under a free enterprise system, when a commodity is in short supply the higher prices paid by importers go to the producers, so encouraging them to increase supplies. Private importers can and do also find new sources of supply. It is worth their while to buy small quantities, so stimulating production in countries not normally regarded as world suppliers. These small quantities *in toto* may amount to a substantial figure, but where the government is the sole importer it will not, as a rule, buy small quantities, nor is it in a position, again for political reasons, to go into the producing country and offer special inducements to the growers as can a private trader who, not infrequently, finances small producers."[1]

Confirmation for the above view is to be obtained from a speech by Mr. John Lewis, the Socialist M.P. for Bolton. "We are told that it is difficult to get certain raw materials in the United States. The Board of Trade makes representations to our Raw Materials Mission in the United States and sometimes they succeed and at other times they fail but I know for a fact that in the United States there are merchants in every big town who have a large stock of raw material on their hands and that, whereas Missions have made representations and failed to obtain the materials required, private buyers have gone over there and purchased them."[2]

The device of the long-term contract is justified as an inducement to countries to produce the commodity. But where there is a large market for a commodity and especially where there is a world market, individuals have always produced in the belief of being able to sell. Most production is in anticipation of demand and Britain has been supplied with a large variety of commodities without having to enter into fixed contracts. British agriculturalists have complained in the past that foreign

[1] London Chamber of Commerce, *Commentary on the Economic Survey for* 1947, p. 5.

[2] *Hansard*, 26th June, 1947.

supplies have been too readily available! A government contract may or may not encourage production in the countries where the contract is made, according to the terms of the contract. But the countries which do not get the contracts and which know that all purchases are being made through the British government would be foolish to enter into great productive commitments. Thus a possible source of supply is never allowed to come into being. If the crop fails in the contract countries there is nothing to fill the gap. Not only are all the eggs put into one basket but other suppliers are prevented from filling the basket. The growth of new areas of supply has been a feature of the cotton, coffee, tea and rubber industries. Fixed contracts would have prevented that development.

Consumer's choice

A fundamental objection to the government making contracts for supplies and monopolising the buying of commodities is that the choice of commodities bought is the Minister's, which is not the choice of the individual consumer. The choice to the consumer is cut down because the goods are not imported. In an extreme case, if the Minister concerned were some food faddist we might get no supplies of meat at all because the Minister thought that meat was bad for us.

Even in less extreme cases the government decides how the domestic consumer will spend her scarce resources. "I did not, however, see my way to permit the importation of potatoes at prices beyond the reach of most housewives."[1] The government decides that the consumer is to have a brand of foreign cheese commonly called "mousetrap" in place of the traditional brands of English cheese and exhorts the citizen to lower his standard of bathing to that of a Cabinet Minister.

Criticism has been directed to the fact that purchases of expensive foods have been made and also to the lack of variety in the diet, criticisms which to a certain extent cancel each other out. But the reason that either type of criticism can be made is that it is a government department which is making the decision for the individual consumer and not in every case is the consumer satisfied.

[1] *Hansard*, 25th June, 1947.

CHAPTER XII

THE CONTROL OF PROFITS

GOVERNMENT control of profits presents several difficult features. Apart from the general difficulties of price control there is the difficulty of definition, as the word profit is used in a variety of senses. What the government controlling profits generally has in mind is the control of industrial profits or the return to the investor in various enterprises. But the return to the investor or the capitalist is compounded of two items, the return on capital itself and "profit" in the economic sense. The economist distinguishes clearly between interest on capital, which is the return on money lent to others and profit, which is the return to the entrepreneur for the risk-bearing function. Whereas profit in the normal commercial sense (and particularly in the sense of a dividend paid by a company to its shareholders) is a single payment covering interest and economic profit. There is no allocation of the total sum between the two sets of returns which are included in the one payment.

Interest on capital

Interest is the payment for the use of capital and will vary with the rate at which money can be borrowed, coupled with the security of the loan. If we take a government loan in an advanced country where the government credit is good so the loan is not liable to default as a "safe" investment, then the rate at which the government borrows may be taken as the current rate of true interest. As the security is good the interest is payment for the use of the capital lent. The rate at which money is lent to other than governments will depend on a number of factors. The main consideration is the risk involved. If the borrower is believed to be of doubtful credit, so that there is the risk that the money will not be returned, then the lender will require a higher rate of return on his capital. The extra payment of interest is not true interest but partakes of the nature of an insurance premium for the additional risk which he is incurring.

Where the borrower requires the capital for business purposes the lender is providing the money on the security of the business. If the business fails the borrower not only may lose the capital that he has put in the business but he may also lose the capital of the lender which he has used. So a lender of capital for business enterprises has to face the risk of their failure and consequently will demand a higher interest payment to compensate him for the risk involved.

True economic profit

While the extra payments for the additional risks undertaken are part of gross interest and not true net interest and they approach the payment of profits in the economic sense, they are not true profit in the narrower economic sense. Interest is a payment due from the borrower to the lender irrespective of the purpose for which the money is borrowed, profit is something different.

The entrepreneur collects together different factors of production to make a product or to provide a service to the community. He buys these factors at their respective market prices. Labour of different kinds is hired for which he pays the rates of wages and salaries required for the varied services supplied; land is used for which he pays the normal commercial rent; and capital is borrowed at the current rate of interest for capital used in that particular type of enterprise. The business man buys these factors of production at the time of use in the expectation that the total sales of the product or service that he is providing will be sufficient to cover his costs. The costs are incurred now in the expectation of return in the future. A time lag occurs between the payment of his costs and the recovery of his receipts. In the meantime anything may happen. His expectations may be disappointed. He may miscalculate the market. On the other hand the results may more than justify his anticipations. Receipts may be more than expected.

Profits are residuary

Profits are therefore a residuary item after the prior payments to the other factors of production have been deducted from the receipts. If payments for factors were made and bargained

for at the same time as receipts were made for the sale of the product, the time element would be eliminated and it would be possible for the entrepreneur to know if his returns were to be equal to his costs and the risk element would be eliminated from his calculations. As profits are what is left over when all other payments have been made it follows that if there is nothing left there will be no profits. If the receipts are insufficient to cover the expenses there will be a loss which will fall on the entrepreneur. The loss will either be borne by his own resources or by the capital which others have put into the business. All other factors of production get their price whether the enterprise is successful or not, the profits depend on the success of the entrepreneur in correctly forecasting his costs and his income.

What has been said about the entrepreneur as an individual applies equally where the function of entrepreneurship is carried on by more than one individual. If the enterprise is operated by a local authority or a government there is the same possibility that the future receipts will fail to cover the outgoings and the difference will be made up by the taxpayers. The taxpayers are compulsory entrepreneurs, and whether they will it or not they are financially interested and involved in the failure or the success of such government enterprises.

Profits and competition

Under conditions of perfect competition profits would tend to be reduced to nothing in a static society. Assuming that there were free and perfect mobility between factors of production and industries a high rate of profit in one industry would attract to itself entrepreneurs who would hire the other factors of production at their market prices and sell the produced commodity at its market price. The additional entrepreneurs attracted to that particular branch of production would cause the average receipts of all the entrepreneurs to fall, for with perfect competition demand would be transferred freely from one entrepreneur to another. The fall in receipts would cause a fall in profits and the process would go on until there were no more profits left when the payment for factors of production had been made.

On the other hand if losses are being made in an industry

entrepreneurs will be driven out into some other industry or into the wage-earning class. Existing sales will be shared among fewer entrepreneurs and losses will be lessened. This process will go on until sufficient entrepreneurs have left the industry to bring the industry into equilibrium and losses cease to be incurred. Therefore with perfect knowledge, perfect mobility of factors and an unchanging world profits would cease to exist and the total receipts of an industry would be shared among the three factors of land, labour and capital.

The profit which is eliminated in conditions of perfect competition and a static society is of course net economic profit. It does not mean that there is no return to the entrepreneur for undertaking production. The return to the entrepreneur will be his gross profit in the sense of the income which he earns at that particular trade. And his income will be compounded of other elements than pure economic profit. If the entrepreneur, as is usually the case, provides the capital for the business and he receives from that business the normal return only on capital, a return which he could obtain by investing that capital in some form of safe security, then the profit which he is receiving from investing in his own business is obviously nil. If he works in his own business part of his return is due to his own efforts, and he really has to charge himself the wages due to himself for the work done. (As is often done in the adjustment of accounts in partnerships.) If he provides his own land and premises part of his return is the rent attributable to the use of that factor of production.

"Negative profits"

When from his gross returns in the income tax sense of profits is deducted the value of the work done by the owner, the interest on the capital employed in the business, the residue of profits may quite easily be negative. In other words the owner of the business would do better by working for someone else at the current rate payable for his particular skill and by investing his money in safe securities. Probably over a large field of business endeavour true "profits" in the economic sense do not exist. (There are certain imponderables to be taken in account. If the owner would rather have his own business than be an employee

in spite of the negative rate of profit, then the personal satisfaction accruing to the entrepreneur is a net gain to himself. He is paying for the satisfaction of being his own master.)

Risks of production

When we remove the assumptions of perfect competition and perfect knowledge of the future it is easy to see that total receipts from the sale of the product in the future may exceed or fall short of the total expenditure incurred in the past on bringing the commodity to market. The element of risk, which may be ignored in the static society, becomes of great importance in a changing world. Where changes are taking place; where industries are rising and falling; where consumers are liable to transfer their demands from one product to another; where technical inventions may alter the fortunes of one industry favourably and another unfavourably; in all these circumstances it is impossible to foresee that certain expenditure in the present will give a commensurate return in the future. The more changing the conditions are the greater the chance of profit or of loss.

The introduction of new products to the consumer involves the risk that the consumer may not want the product when it is offered to him. Any profits which are eventually made are a reward for taking the risk and for proving that the investors were right. They could quite as easily have been wrong and lost their money. When Henry Ford devoted himself to automobile construction many of his contemporaries thought that he was mad and that the future of transport lay with the railroads. He made a large profit by proving that he was right and the majority opinion was wrong. Without the supply of people willing to bear the risks of new enterprises progress would never be made and we should be at the standard of living of the Middle Ages. And from the large profits made by the successful projectors must be deducted the losses made by the unsuccessful who took the risk and lost. The economist expresses this by saying that the willingness to bear risks is a factor of production as well as land, labour and capital, and while it is easy to be wise after the event the risk is taken before the event.[1]

Profits are more easily made when society is progressive and

[1] *See* Pigou, *Economics of Welfare*, Appendix I.

payment to the risk bearers is part of the cost which society must bear for the necessary progress in its standard of living. Further, the profits made are gross profits. From these gross figures should be deducted the losses incurred by the unsuccessful enterprises for us to arrive at the true return which accrues to the function of risk-bearing. The more risky are the conditions of business the more likely are there to be great profits and great losses. Whilst certain projects may make large profits they are likely to be counterbalanced by large losses. In general the gross profits have to be sufficient to cover the losses in order to maintain the capital for current use and for the development of new enterprises.

Control often unnecessary

Government intervention to control profits is not necessary under normal conditions. Where excessive profits are being made entrepreneurs will be induced to enter the high profit industry and their competition will reduce the high profits. In any case the control can only arrive after the event has taken place. As the profit cannot be foreseen the control cannot be applied until after the profit has been made. If the profit is so certain before the enterprise is undertaken there would be sufficient people venturing into the industry to keep down the rate of profit.

But where entry to the industry is restricted high profits will not bring their own corrective. As new firms are unable to enter, the firms still in the industry may continue to earn more than the gross rate and there is a net profit over and above the expenses of bringing the commodity to market.

The principal industries in which the difficulties of entry give rise to monopoly conditions are to be found in the public utility group, such as railways, canals, gas, water, electricity and telephone supplies. These special problems are a legitimate reason for State intervention, so much so that the State often intervenes to grant monopolies or exclusive privileges to the people engaged in these activities. The problems because of their special importance are considered in Chapter V. Various devices have been used to control the profits of these enterprises and to prevent the public from being exploited.

As the special problem of public utilities is not being considered here and, as it is contended, there is otherwise no special problem in "normal" conditions the problem arises of profit control under conditions which are not normal.

Rising prices give easy profits

Although in the long period there is the tendency of profits to be reduced to nothing periods of rising price are periods when business profits are easy to make. Business undertakings make increased profits and declare higher dividends to shareholders and there is a feeling in some quarters that profits are taking an undue share of the national dividend.

There are three reasons for the increased profits made during a period of rising prices. Firstly, the greater confidence and the inducement to embark on enterprises means that there is greater activity. Turnover is greater, so that while the profit margin per transaction may be the same as before, the larger turnover leads to larger total profits for the entrepreneur. His expectations that there will be a sale for the product which he is putting on the market are realised.

Stocks

Secondly, periods of rising prices give increased profits because of the profits made on stock-in-trade. Raw materials and components are bought at one price and by the time that they are turned into some other product for sale—and this time-lag varies with different industries—the price of the finished product has risen. There is thus a wider margin between costs and receipts. Larger profits are earned *while prices are rising*, not because of the higher prices in themselves. Once prices have settled down to the new and higher level the costs of raw materials and the prices of finished products will both have risen. There is no reason why the new scales of prices should exhibit a greater or a lesser margin between buying and selling prices. It is not the high prices which give the higher profits, it is the *rising* prices which are the cause of the greater profits.

The higher profits as shown by commercial firms are a result of present accounting technique. Stock in hand is valued by accountants at cost or market value, whichever is the lower.

Let us take as an example a firm which has a stock of 1,000 articles valued at £1 each at the beginning of the year. During the year this stock has been turned over several times so that the same stock at the end of the year has cost the firm 30s. per article. There is a difference between the values of the opening and closing stocks of £500 which will be shown as profit. The physical stock is the same, but its value has increased and the assets of the company have increased accordingly.

Once the price rise has been arrested selling prices will no longer increase and new purchases of stock will have to be made at the higher price (30s. each article). So there will be no further profit to be made on stock appreciation. The business will settle down to a new level of costs and receipts. The £500 of profit is really a non-recurring item and not a profit on income account. This money should not be regarded as part of the trading profit of the undertaking. As a trading profit it is an illusion which will fade away if prices fall.[1]

Importance of fixed capital

Thirdly, periods of rising prices show apparent commercial profits because of the lower charges on capital equipment. Besides using stock-in-trade different industries use varying proportions of fixed capital. The fixed capital will be bought at different times and will have unequal periods of life. In assessing the profits made by an undertaking over a given financial period allowance has to be made for the wearing away of the fixed assets that are used to make the profits of the firm. A profit is not made unless the total receipts are sufficient to repay the firm for the loss of its fixed assets as they wear out.

The normal method of allowing for this is by making provision for depreciation in the annual accounts. Methods vary and are subject to some controversy among accountants. But the objectives of the different methods, such as the Straight Line or the Diminishing Balance, are the same. They are to write off, over the period of the life of the asset, the original cost in money

[1] A similar abnormal profit on stock was made in 1947 by the Imperial Tobacco Company when additional duties were levied on tobacco. This was correctly treated as an abnormal profit and carried to reserve

of providing the asset. If £10,000 has been expended in providing a particular piece of equipment and when that equipment is worn out its book value has been written down to nil (or to its scrap value if it has any), the accountant has recovered the money cost of that equipment. The annual allocations for depreciation are charges against the profits of the years in which the charges are made. Where prices remain steady the amounts recovered at the end of the life of the asset are sufficient to replace the old machinery by fresh equipment. The capital of the firm is maintained at its original amount.

Difficulties arise when there is an increase in the price of the equipment before it is worn out. If the replacement cost is greater than the original cost, depreciating on the original value will mean that the amount set aside in the business, although sufficient to cover the money cost of the installed equipment, is insufficient to cover the cost of replacement. An asset is being worn out and its original cost is being charged to the present profits, but the business is using up more than it is capable of replacing. Accountants work on the assumption that the value of money is constant because money is their measuring rod. So they usually state that if the replacement cost is greater than the original cost the depreciation applied need only be sufficient to cover the latter sum. Any further amounts required on replacement are matters which involve an increase in the capital. This is true where the replacement is dearer because a larger or a better machine is being installed, but it is not so where the increased cost is due to a fall in the value of the money.

The real assets of the country are not altered by alterations in the value of money. If the value of money is halved, then assuming that all prices are affected equally the money value of all assets is doubled. If businesses throughout the country allowed for depreciation in such circumstances on a basis of the original money cost only and distributed the accounting profit as a dividend, they would be living on their capital. In fact they do no such foolish thing. While the accounting profit, and of course the published profit, shows a great increase due to the rise in the price level, the essential illusory nature of the increase is recognised by the firms placing larger sums to reserves for various purposes. These reserves are in reality the allowance

in the books for the fact that the original capital, in real terms, has increased by the decrease in the value of money.

This accounts for the fact that industries which make use of much fixed equipment having a long life of usage have had to increase their charges to the public to a considerably lesser extent than other industries. The increases in the costs of electricity, gas and railway charges have been much less than the increases in the costs of many other commodities. We buy our coal at current costs, whereas we largely buy our electricity at costs which are partly current and partly measured in pre-war money costs. Of course, as the equipment wears out and has to be replaced it will be replaced at the existing cost of replacement. But in so far as the asset does not need to be replaced, such as a railway cutting or embankment, present cost is proportionately lower, due to the fall in the money cost between the time when the asset was first constructed and what it would have cost if built at the present day.

Therefore a considerable part of the increased accounting profits as disclosed by the published accounts during the period of a price rise are largely paper profits and not real profits. In so far as they are treated as real profits they involve the consumption of capital by failure to provide for the adequate replacement of the assets which are wearing out over a period of time. The apparent profit is in effect consumption of capital.

Falling prices

The increased profits, real and imaginary, in a period of rising prices are either due to that price rise or to the fact that prices are *rising*. They are to be found during the period of the upswing of the trade cycle. During the period of the down turn of the trade cycle when prices and costs are falling the effects on the accounts discussed above will be reversed. Profits will fall because of the reduced business activity. They will also fall because stocks of goods purchased at the higher price will have to be sold at a lower price. The same physical volume of stocks carried over from one balance sheet to another will be carried at a lower figure. So the fall in the value of stocks will be reflected in the lower profit margin in the trading account. (Fresh stocks can, of course, be bought at the lower figure; it is the *falling*

price, not the low price, which causes the diminution of profit.)

Profits will fall because the capital assets purchased at the boom prices will be able to earn revenues only from the sales of products calculated at the lower prices. The depreciation on the original values will be calculated to cover the cost in money when the assets were bought, yet the replacement cost of the dear machines as and when they require replacement will be less than their original cost. Profits will be charged with a larger sum than is required to replace the same volume of physical assets. As the boom is largely the construction of capital goods, it is those goods which will rise in price and hence will bear an inflated value in the accounts of the firms which have replaced equipment at a period of high prices. In fact the high paper profits of the boom are apt to melt away like snow in summer during the slump.

Fall in value of money

It is of course incorrect to believe that the price rise of the boom is compensated by the fall in the slump, i.e. that prices rise and fall about some natural average. The trade cycle movements are largely medium-term movements. In the long period the trend of prices may be up or down. Generally they are up. The control of money and credit is in the hands of governments and governments have a chronic inability to preserve the value of the money which they are issuing to the public. (The "pound" was originally a pound in weight of silver.)

As the tendency is for the value of money to fall (i.e. for prices to rise) over the long period, with oscillations about the general movement, the effects of price changes on the economy of different firms will make themselves felt. Part of the published profits are a consumption of capital, except where they are covered by appropriations to reserves. Also the same money profits have a decreased purchasing power in terms of goods which have risen in price. In terms of current purchasing power the same money profits may well represent a fall in real profits. For example the Standard Revenue which railways were not allowed to exceed under the 1921 Act was based on the revenue which they earned in 1913. Although the money profits would

have been the same the real value would have been different. (This Standard Revenue was never earned between the wars due to causes unforeseen by the drafters of the Act in 1921. When it was exceeded during the Second War the government acquired the benefit.)

Long period price rises are mainly a result of war and war-time inflation. The increased activities due to the development of "new" war-time industries, coupled with the methods of government financing, cause prices to rise. Rising prices cause profits to rise, very often in a greater proportion. War-time finance and boom conditions are only a special case of a general inflation of the currency. But they are a special case. Here it is felt that the self-acting economic system would not be equitable. People and firms who were lucky enough to have the goods which were required in a war economy would make large profits. It is considered objectionable that some should make "profit out of the war" and therefore war profits should come in for special taxes.

This doctrine is not so completely applied to wages. The man who makes the gun does not have his earnings restricted to the pay of the man who fires the gun. While wages were not restricted in this way they did not rise unduly in spite of the absence of control, or perhaps because of the absence of control. The real facts of the situation were appreciated by the non-fighting sections of the population, so the economic conditions which would have led to a great increase in wages did not do so during the war years, due to "reasonableness" on the part of the wage-earners.

The practical difficulty of making a specific control of *war* profits meant that controls were attempted on *excess* profits in general.[1] All extra profits were considered to be war profits. The methods of control used varied in different circumstances.

"Cost-plus"

Price control of the product sold was one obvious step to take. The implications of price control on the market price of commodities have been dealt with and need not detain us here. In the special needs of a war economy there were particular

[1] *See* Hicks, *The Taxation of War Wealth*, passim.

disadvantages. If the product was one required for the economy and costs of production were rising the limitation on price discouraged supplies coming on to the market.

Hence the government adopted other methods of which cost-plus was one. The producer sold his commodities to the government at the cost price to him and in addition he was allowed to add a certain percentage of profit. The disadvantages of cost-plus have been discussed and in times of peace there is little good that can be said about it. There is no incentive to cut costs and there is the endless argument with the government accountants over what is and what is not to be included in the costs of production. Even with a price control on the product as well it did not stop large profits being made owing to a greatly increased turnover.

The excess profits were therefore allowed to be made. In fact they could not be prevented without causing a breakdown in the system of supply. But the government got them nearly all back by levying an Excess Profits Tax of 100 per cent. Into the special legal and accounting difficulties of the war-time E.P.T. it is not necessary to enter. Once the permitted profit had been made all excess profit accrued to the government. This type of tax is universally admitted to be a barrier to efficiency. It is to no one's advantage to keep costs as low as possible. In fact it is often a short-term advantage to the business man to increase his costs. If he grants increased wages he may get a reputation for generosity to his employees but the generosity does not come out of his own pocket. And any expenditure which will bring some advantage in the future, no matter however slight, will be worth incurring because it does not come out of the profits of the business. As part of the inflationary profits are illusory the tax on excess accounting profits is really a tax on the capital of the firm. As there was no justification for its retention the E.P.T. was therefore repealed after the war.

Profits tax

But the idea of a special profits tax still lingers on. Companies are now liable to a special profits tax with a higher rate of tax on distributed earnings. This form of tax has certain objectionable features.

While all taxes mean that the taxpayer is deprived of an income which he would otherwise possess and are therefore a burden on the payer (except that where the money is spent wisely by the government the taxpayer gets a value for his money), some taxes are worse than others. The income tax payable by public companies is a tax on the owners of that business. If the shareholders are not personally liable to tax they can obtain a repayment of the tax paid on their behalf by the company. The company is here merely an unpaid collector of the revenue on government account. But a tax on profits additional to income tax means that the company itself is taxed. Therefore the dividend rate has to be reduced to pay this tax and shareholders with low incomes are paying a very high rate of tax. If the tax instead of coming out of dividends comes out of the reserves of the company the position with regard to the shareholder is the same. The value of the business is less by the amount of the tax and the future earning power is less. The capitalised loss of earning power therefore falls on the shareholder in the same way as a reduction in the rate of dividend. If the purpose of the tax is to raise a revenue for the State it is inequitable to devise a method of taxation which bears proportionately harder on people with low incomes because the same rate of tax is payable whatever be the shareholder's income. The small shareholder is unable to obtain repayment of money paid out by the company in profits tax.

Ordinary shares

A further objectionable feature is that the tax falls entirely on the holders of ordinary shares. Before the ordinary shareholder receives a dividend the priority payments of interest on debentures and dividends on preference shares have to be paid. The ordinary shareholders obtain the remainder, less the amounts that are left in the business by being placed to various reserves, etc. The ordinary shareholder is therefore paying tax on the profits which accrue to the preference shareholder. If preference shares were replaced by debentures which are obligations due to creditors, or even if they were replaced by bank loans, the interest payable would be a charge on profits *before* the tax was levied. So the incidence of the profits tax will vary with the

capital structure of the firms. Firms which exist on a larger proportion of borrowed capital, which is hardly a wise thing to do, are less heavily taxed than firms whose shareholders are willing to bear on their own shoulders the whole of the risks of the enterprise.

Risk-bearing

The tax is objectionable because it is a tax on the function of risk-bearing. The greater the risk borne by the shareholder the greater is his tax. The entrepreneur hopes that the profits on the successful ventures will pay for the losses on the unsuccessful. If he is to bear the losses on his bad guesses and be deprived of the gains on his good guesses, then this is a deliberate discouragement of enterprise. At a time when the country needs all the enterprise and ability that it can get this is a particularly pernicious policy.

As the income tax laws distinguish between earned and unearned incomes, incomes from investments are already specially taxed without any new types of taxes. The machinery is already there and the revenue could be obtained by further differential taxation on unearned incomes. The incomes of the poorer would be safeguarded and enterprise would be less discouraged. The curious anomaly that the investor in a government loan gets his full rate (less income tax if payable), while the investor in industrials pays income tax and profits tax, would no longer exist.

Dividend limitation

Limitations of dividends, either compulsory or voluntary, also present difficult features. The limitations may be applied by stopping increases of dividends from a certain period or by fixing a maximum rate of dividend which may be paid.

The proposal that dividends shall not be increased beyond those paid in any year, say 1947, is most arbitrary in its effects. Some firms had not been adversely affected by the war. They were enabled to add to their reserves. If they were making products which were of value in peace and war they should be in a position to pay adequate dividends in the post-war years. If they had paid high dividends in 1946 and 1947 the limitation

on dividends would little affect them. They could continue to pay high dividends.[1] And the high dividends would be expected by those shareholders who had bought the shares at a capital cost which reflected the expectation of good results. Even a high percentage rate of dividend might be no more in real purchasing power than a lower rate paid before the war.

Again, firms which had pursued a policy of distributing profits "up to the hilt" and so were paying high rates in the post-war years could continue to pay them. A similar firm might have made the same rate of gross profit. But it could place more to reserves to assist the reconstruction of the firm. The object of the policy would be to pay less then so as to be able to pay more now. The business would find that its permitted rate was that of the lean years. Those which had followed Dr. Dalton's invitation not "to chuck money about" would find themselves hamstrung as a consequence.

There are other firms which have experienced difficulties in changing over from war to peace, very often due to circumstances beyond their own control. Now that the period of change is over they are to be judged as profit-making concerns on the basis of the years of difficulty. If they had been financially unable to pay a dividend in the base year they would be legally unable to pay a subsequent dividend. The profits of some firms, due to the nature of the business, exhibit a cyclical fluctuation. Profits over the cycle may vary from nil to a fairly high rate; the average over the period may be no more than moderate. If the high rate is taken as the base they may never earn enough to pay what they are allowed to distribute; if the low rate is taken they are forbidden to pay out an average return.

It may be objected to the above analysis that these firms will still be able to pay out in dividends the same average over the period. The profits earned in the good years, which they are not allowed to distribute, will thus accumulate as reserves and will be available for distribution when the profit rate falls. This is a dangerous practice. When the profit rate falls it is impossible to know whether the decline is purely cyclical and hence will be reversed in later years, or whether the decline is permanent.

[1] The dividends will be apparently good because they are calculated in present money as a percentage of pre-war capital.

Optimism would say that the decline is temporary but the facts may be otherwise. Although profits may legally be distributed out of reserves of former undistributed profits, it is not a practice which finds favour with accountants; nor, since the Royal Mail Steam Packet Company case, where dividends were paid secretly out of past profits, is it one which directors are likely to pursue. The policy of putting a high mark to dividends is the policy of cutting off the peaks without filling in the valleys and thus reducing the general level.

Capital and reserves

A limitation of dividends in the form of a certain permitted rate of return on capital ignores some much misunderstood features of the capital structure of business enterprises. A sharp distinction must be drawn between the original *subscribed* capital of the firm and the amount of capital actually *used* by the firm. If a firm is started with a capital of £1,000 divided into 1,000 ordinary shares of £1 each and it places to various reserves each year sums equivalent to 5 per cent of its capital, then in twenty years the capital employed in the firm will be doubled. This may be illustrated as below:—

Year	1	Capital £1,000	Earning assets £1,000
Year	20	Capital £1,000 Reserves £1,000	Earning assets £2,000

The reserves employed in the business are as much a part of the capital as the original amounts subscribed by the shareholders. Exactly the same position would have arisen if the company had distributed all its profits each year, and in year 20 it had raised a further £1,000 of capital from the same shareholders (as they would be putting their money back into the company). The only difference would be that in the former case the company would have had the use of the accumulated reserves for the whole of the period. A dividend of 10 per cent paid in year 20 is 10 per cent on the original capital of the firm. But it is only 5 per cent on the capital which is being used by the firm and is 5 per cent return on the money which is now invested in the business. The whole of the reserves of the business have been set aside out of past profits and belong to the ordinary shareholders.

Ploughing back profits

A number of firms in the past have regularised in the accounts this policy of ploughing back the profits by issuing additional shares to the owners to cover the reserves which have been created. Shareholders have obtained a dividend in cash to cover the distributed profits and a bonus issue of script to cover the profits which are placed to reserve. They have in effect a certificate to show that part of their profits have been reinvested in the business. In the case of the figures given for the imaginary business on page 178 during the twenty years the shareholders would have received one new share for every old share held. The dividend received would have been 5 per cent on the total share capital. The return to the shareholder would be the same as in the older method but it would more exactly represent the earnings on the capital employed in the business.

An attempt to prevent this development by a special tax on the issue of bonus shares, as is now done, serves no useful purpose. If shareholders are to be encouraged to keep the money in the business (a wise policy which they have pursued for over a hundred years without any Ministerial advice) then there is no harm and a great improvement in the accuracy of the accounts, in their having a piece of paper, or even a form, signed by the directors, telling them that this has been done. The imposition of a special tax on truth in accounting only results in the accounts continuing to be kept in a misleading way.

Discouragement of competition

All this interference with business serves no useful purpose. The case for the control of monopolies and of monopoly profits is not here in dispute. The best control of other than monopoly profits is the presence of competition. One method of ensuring that there shall be competition in an industry is for prospective entrepreneurs to be aware what profits can be made in a particular line of enterprise. The declaration of high dividends is an indication to the investor and to the company promoter that there are high profits in a certain industry. Others are therefore induced to enter that industry. The competition of the new firms will lower profits in that section of industry by increasing the supply of their particular product. If profits are restricted the disequilibrium

between that industry and others where the profits are less will still persist. There is thus no automatic corrective to restore equilibrium between the different industries serving the consumer.

Profits and competition

The attempt to control profits in a competitive industry is based on the fallacy that high profits result in high costs of production. It is the high selling price which gives the high profit. This is especially true during the inflationary period. The price to the consumer will be based on the supply and demand conditions affecting the particular product and will be independent of the cost structure of the individual firm. Within an industry there will be firms of varying efficiencies, each making different rates of profits on the capital employed in the business. One firm will be selling a product to the consumer without getting any return on the capital; another will be selling the same product at a moderate rate of return; while yet another firm will be selling the same product and obtaining a very high rate of profit. In each case, with competing firms, the selling price to the consumer will be the same. The fact that the shareholders of the third firm obtain a high return on the capital they have invested does no harm to the buyer of the product which that firm is selling. On the contrary, the fact that that form of enterprise is profitable to the supplier is some guarantee to the consumer that supplies will continue. He is not likely to be deprived of the commodities which he wants because of the failure of the firms in the business.

A study of dividends paid by different firms in the same types of business will show that very varying rates of return on capital are earned in competitive businesses all selling the same product to the consumer at the same price. What interests the consumer directly is the price he pays over the counter. The fact that the man behind the counter is making an adequate living is not to the consumer's disadvantage.

Confusion between money and real capital

A second fallacy behind this attempt to control profits and the return on capital is the confusion of thought between the supply of money and the supply of capital. This confusion is made worse by some of the arguments used to justify the policy of present day nationalisation.

If real capital is so plentiful that it can be utilised only at low rates of interest then productivity will be increased by the abundance of this real capital available. But the advantage to industry is the abundance of capital as a factor of production. The price at which it is offered is irrelevant to its productivity.

Cheap supplies of capital are advantageous and cheap money in normal times signifies that the supply of capital is plentiful in relation to the demand for capital. Cheap money, the offering of much capital on the money market, is symptomatic of an abundance of real things.

In abnormal times an artificially manipulated interest rate on money is no criterion of the real rate of return on productive capital. Nor is the low rate an indication of the scarcity of real capital. There are advantages attributable to a cheap money policy from the point of view of the budget finances but this does not affect the supply of capital to industry.

"One of the chief benefits from the nationalisation of transport would be the availability of cheap capital, and the assurance that the money would be spent where it was most urgently needed," a Minister of Transport is reported to have told his followers.

Nationalisation will not provide cheap *capital* although it may provide monetary capital on special terms to the nationalised industry. But it is not money which is needed. We have had a plethora of money in recent years and only now is there a slight sign of the flood abating. A change of ownership of any industry will not increase the availability of real capital for reconstruction. It means just that the nationalised industry will be in a privileged position compared with the other needs of the community.

What the transport industry needs is re-equipment and this entails a supply of iron and steel, timber, bricks, etc., and the labour to put them into productive form. In real terms, apart from financial juggling, the cost of the capital is the cost of the labour and materials required. If more of these scarce factors of production are used in railway construction there will be fewer resources available for other purposes. The more timber used for railway sleepers, the less timber there is available for house building. New houses now have concrete floors because of the competing uses for timber.

Enterprises will vary in their expected yields. Some will yield

10 per cent on capital, some 5 per cent, and some 2½ per cent. If the real rate of return on capital on the average is 5 per cent, any capital devoted to an industry which would yield 2½ per cent only is misdirected capital. The capital would be far better employed in an industry where the yield is greater. Where capital is artificially supplied to an industry at a specially low rate it will deprive other industries of real capital resources which could there be more profitably employed.

The cost of capital is the cost of the resources which are devoted to that particular purpose at the moment when the resources are expended and at no other time.

It is, of course, objected that this is not the true meaning of cheap capital. If capital is borrowed at a lower rate then the industry will be committed to paying a smaller interest charge in the future. The burden on the industry is less because capital charges are less. If payments for capital are 2½ per cent, so runs the argument, the fixed charge will be half what it would be if interest rates were 5 per cent.

Payments from the industry are less, the income of the lenders is correspondingly less. From the community point of view this is a case of the transfer of wealth between different people in the country. The *real cost* was incurred when the capital was expended; subsequent capital charges are transfer payments only.

The Ministry of Health, for example, has a large housing programme mainly financed by borrowing. This programme will entail the expenditure of present and future resources. It is pointed out in a Ministry statement that the rise in the cost of post-war houses has been partly offset by a reduction in the rate at which local authorities borrow money, as the rate has fallen from 3⅛ per cent to 2½ per cent. This does not reduce by one penny the *real* cost of the housing programme, which consists of the wages of the employees and the cost of the raw materials used. What it will affect in the future is the level of local authority taxation; holders of local loans will get less, rates and taxes will be at a lower level. The cost of the housing is paid for at the time of construction and considerations of local taxation, while they are important, do not concern the present cost of providing capital goods.

Even Mr. Barnes's assurance that low rates of interest on

government borrowing will ensure that the money would be spent where it is most urgently needed is not true. Where capital is provided on cheap terms it is more likely to be wasted than when it is provided on dear terms. In the latter case the cost is more likely to be closely watched.

The government proposal to provide 25 per cent of the cost of reorganisation of the cotton industry, while it may be of benefit to that industry, will withdraw capital from other uses. There may, or may not, be good reasons for subsidising one industry. It must be remembered that this will entail a real cost to the rest of the community. It will not be "free" capital.

These points at issue are similar to the old controversy regarding Municipal Trading when it was claimed that where a municipality established an industry, such as gas, electricity, or transport, the credit of the rates made it possible for the local authority to borrow at a cheaper rate than could a similar private enterprise undertaking. If there were a loss, as has at times been the case, the loss was borne by the ratepayers instead of by the company shareholders. The real loss of the undertaking would be the same in each case.

If all enterprises were publicly owned, the supply of capital would be exactly the same; the risks attached to future production would be the same; the cost of any enterprise, though disguised, would be unaltered.

If the Transport Commission, the Coal Board, the Electricity Authority and the Gas Board are to get capital on special terms the rest of industry will have access to the depleted sources of capital on less advantageous terms.

The cheapest way to raise capital is on equity terms. No matter how low be the rate on borrowed money the subsequent interest payments will be a charge on the profitability of the particular industry. If capital is raised on an equity basis there is no burden on the future business. Payments for the use of capital are made only, and in so far as, the expenditure of the capital has been proved justified by later events.

Economic Salvation can come only from capital Works, not from monetary Faith.

CHAPTER XIII

THE STANDARD OF LIVING

"THE annual labour of every nation is the fund which originally supplies it with all the necessaries and conveniences of life which it annually consumes, and which consist always either in the immediate produce of that labour, or what is purchased with that produce from other nations." So Adam Smith opens his *Inquiry into the Wealth of Nations*. He emphasises the simple truth that the standard of living which a nation can enjoy depends upon the amount of production which that nation brings forth. Where productivity is high the people can enjoy the necessaries and conveniences of life in abundance; where productivity is low it is useless to expect to live well.

It is perhaps worthy of remark that while to-day we are complaining of our poverty, Adam Smith in 1776 entitled his book *The* Wealth *of Nations*. Yet few to-day would regard the average standard of that time as being high and more people would regard eighteenth-century living conditions as being distinctly low for the great mass of the people.

The reason for this is that while the standard is an absolute standard in that it consists of certain goods and services which can be measured and valued, it is also a question of comparison. People do not judge their standard of living according to some index number of prices but by some everyday facts of which they are themselves conscious. The principal means of evaluating their own standard is by comparing it with that of some similar people. Under some governments they are able to do this by visiting other countries. They can then return home and express envy of the wealth of others or they can thank God that they are not as other men are. An almost equally valid test is to compare the standard now with what it was at some previous period such as before the war. The disadvantage of this test is that the further back in time that the comparison is made the fewer are the people who can remember. The rising generation takes its own standard for granted. The son of the new rich does not feel better off because he is not forced to experience his father's early struggles;

and a generation may grow up to whom the idea of strawberries and cream is just an old wives' tale.

Living and existence

This standard is largely a subjective state in the consumer's mind and is not a matter of figures and index numbers. Consequently, the interesting fact emerges that a rise in the standard has different effects upon the consumer from a similar fall in the standard. Where productivity is improving gradually—and it can only improve gradually—the increase in standard is soon absorbed. The new commodity on the market is at first an unattainable luxury. Later it becomes so cheap with increased productivity that the consumer is now able to afford it. This new article soon loses its special value and gets taken for granted in the family budget. But when the consumer is deprived of an article to which he has grown accustomed he feels the dissatisfaction of that loss greater than he felt the satisfaction of first obtaining the article. People express little enthusiasm if they are told how well off they are because they obtain a supply of water laid on to their houses at a purely nominal cost. Yet if they are deprived of this necessity of life they would soon notice the difference.

The standard of living has to be distinguished from the minimum amount necessary to keep the consumer alive and working. In some stages of industrial organisation there is little difference between the two concepts. The poorer that a nation is, the greater is the proportion of effort which is needed to provide for the basic necessities of life: food, clothing and shelter. In such a stage the price of food and its relative abundance or scarcity is of paramount importance. In the "Hungry Forties" (1840's) the price of corn and consequently of bread was of much greater importance in people's family budgets than it is at the present day.

A limited number of foods will suffice to keep the human body working. Corn or rice or potatoes have in different countries and in different ages provided the main source of nourishment for the working population. A certain minimum of clothing and shelter will keep out the cold. At such a level of existence life is poor, brutish and short. It is only when the standard is raised above the mere subsistence level, when a greater variety can be introduced into food and clothing, when shelter can be improved and when

over and above this man has resources left over for the satisfaction of other needs, that we can begin to think of a real standard of living. Ricardo clearly had this distinction between living and mere existence in mind when he wrote:—

"The friends of humanity cannot but wish that in all countries the labouring classes should have a taste for comforts and enjoyments, and that they should be stimulated by all legal means in their exertions to secure them. . . . In those countries where the labouring classes have the fewest wants, and are contented with the cheapest food, the people are exposed to the greatest vicissitudes and miseries. They have no place of refuge from calamity; they cannot seek safety in a lower station; they are already so low that they can fall no lower. On any deficiency of the chief article of their subsistence there are few substitutes of which they can avail themselves and dearth to them is attended with almost all the evils of famine."[1]

He also declared that "many of the conveniences now enjoyed in an English cottage would have been thought luxuries at an earlier period of our history,"[2] and we can easily think of many commodities such as the great variety of tinned and preserved foodstuffs, electricity, wireless, artificial silk, the bicycle and the motor 'bus, etc., which are now enjoyed by the poorest, yet were unknown to the richest man of Ricardo's time. Therefore we must discuss the standard of living in general and not be concerned only with the supply of the most elementary commodities.

Food

Many of the present day discussions on the standard of living ignore the distinction between living and bare existence mentioned above. In particular the preoccupation with calories of food is avoiding the real problem. Admittedly, it is easier to produce figures for the calories equivalent of the basic foods than it is to take into account the mass of data which is contained in a real standard of living. But because it is easier it does not mean that it is more true or more useful. "Man cannot live by calories alone," and to argue along the lines of calories is to treat the human being as a machine which has to have so much energy

[1] Ricardo, *Principles of Political Economy*, Chapter V. [2] Ibid.

pumped into it in order to give it the strength to work, to pay taxes, and to fill up forms. That is to take a very low view of human aspirations and human nature.

Mr. Strachey estimated that we were consuming about 7½ per cent less food than before the war and that the available food was more evenly distributed.[1] If that is so, then the fall in the standard compared with pre-war cannot be considered to be serious. It is, however, more serious than appears from these figures. There is no single homogeneous commodity "food" in the same way as the classical economists discussed the price of "corn." The fall in food consumption of 7½ per cent is made up of a much larger fall in some commodities but partly offset by increases in certain other foodstuffs.

Some of the principal reductions in average weekly consumption per head between the average of 1934–8 and the year to June, 1947 are: carcass meat 19 per cent; bacon and ham 52 per cent; eggs 44 per cent; butter 56 per cent. Some of the principal increases were: flour 12 per cent; oatmeal 58 per cent; milk 44 per cent; margarine 71 per cent; potatoes 64 per cent.[2] It can be seen that the fall occurs in the high standard foods and the increase in consumption is largely in those foods which are generally known as "fillers." While the average may show no great fall, the figures do show a considerable fall in the real standard of living. (The average would be a calorie standard, there is no other way of taking an average consisting of a fall in the consumption of meat, etc. and an increase in the consumption of potatoes.) Generally, an increase in the quantity of meat eaten is evidence of a higher standard. The English navvies who built the French railways in the early nineteenth century astonished the local inhabitants with their large meat consumption and the amount of hard physical work that they were able to perform. A fall in the consumption of butter and in increase an the consumption of margarine is further evidence of a fall in standards. A large consumption of bread and potatoes shows that people are satisfying their needs with the cheapest foods. They are in danger of being "exposed to the greatest vicissitudes and miseries" as happened during the failure of the potato harvest in Ireland in the nineteenth century (cf. Britain in 1947). Milk is the only quality food which has

[1] *Hansard*, 6th February, 1947. [2] Ibid., 12th May, 1947.

increased. The "shortage" here is a question of milk being distributed in certain ways to schools and to "priority" consumers. (There is certainly need for a thorough investigation into the question of the distribution of milk among the various classes of the community. Many people, for example, would like to know what happens to the school milk in the holidays. Doubtless there is some adequate explanation but no one seems to know what it is.) Milk is strictly on ration in certain districts and yet in others there is a considerable surplus. With the great increase in milk production compared with pre-war it is difficult to see any necessity for rationing. The present "shortage" could possibly be due to the method of distribution brought about by the rationing scheme. The surplus of one distributor cannot be offered to other people because this would infringe various price orders and regulations. Far too much goes down the drain; far too much is wasted.

Quality of food

On the above showing there has been a decline in the standard of living. Some government spokesmen who attempt to deny this are doing so in face of the published figures. They are doing a disservice to the cause they claim to have at heart, namely to increase the standard of living of the people of this country. If the fall in the standard is denied, less effort will be made to correct it.

But the fall has been greater than is shown with the above figures. There has been a considerable decline in the quality of foods and articles of general consumption. This decline is difficult to measure quantitatively but is there just the same. While the food may be adequate to keep the human engine going, the consumer is obtaining less satisfaction from the same quantity of nourishment. Instead of the different types of cheese which were formerly available the housewife has to be content with a ration which offers little variety. The choice and quality of meat has deteriorated. Coal contains a large quantity of slate. Electricity is cut off. Trains are fewer. Postal deliveries are cut down. Newspapers are smaller. Cups and saucers are plain white and purely utilitarian when obtainable. Even to get these supplies the consumer is forced to struggle with ration books and queues.

Even although there has been a fall in the standard (and the

present standard is very exasperating to people who expect, or who have been led to expect, better things), it must be repeated that the essence of the question is the comparative aspect. The standard is probably considerably higher than it was a hundred years ago. It is much higher than that enjoyed in many other countries at the present day. A Chinese peasant would probably think that we had nothing about which to worry. But it is lower than many people remember and lower than many people think it ought to be at the present time.

Increase of leisure

There is, however, one offsetting factor to be taken into account. Since the war there has been a fairly general decrease in the hours worked in a number of industries. This decrease in hours is an increase in leisure. The leisure in itself is a desirable economic good. If we had the same output of goods and services and at the same time we were working fewer hours, that would be an increase in economic welfare. The goods and services would be obtained at less personal cost to the individual. More time could be devoted to other ends than working for a living. If the decrease in hours worked causes a decrease in productivity there is no means of balancing the economic loss of the smaller output against the increase in benefit obtained by the reduction in effort.

The instinct of the employees to take out an increase in real wages in the form of increased leisure is a sound one. It means that they and their leaders are actuated by higher motives than that of obtaining as high a money income as possible. Past civilisations have depended on a leisured class, the more leisure that can be obtained by all classes of the population the better opportunity there will be to build up the conditions of what has been called "the good life."

The policy is sound provided that it is clearly understood what that policy entails. If part of modern productivity is taken out in leisure there is less output of other goods and services. (Except in so far as the increased leisure, by improving the health of the employees, leads to a greater output while at work. But there is obviously some marginal point beyond which a reduction of hours will lead to a decrease in output.) Leisure is an economic good and if we "buy" more leisure we can buy less of other goods.

We cannot have both the leisure and the product of the work that we are not doing. The error is not in choosing leisure, a choice which many of the best and the wisest philosophers would uphold, but in believing that the leisure can be had for nothing.

Poverty

Government intervention to increase the standard of living, apart from general legislation to increase the trade and productivity of the country, usually takes the form of transferring wealth from the rich for the benefit of the poor. This intervention may be by direct money grants, such as children's allowances, or by using the proceeds of taxation to provide at a cheaper rate certain goods and services that are used by the poor, such as free education. If the national dividend is not diminished by the policy it is argued that economic welfare is increased. The economic loss suffered by the rich in being deprived of a certain amount of money, of which they have plenty, is more than offset by the economic gain accruing to the poor. A thousand pounds taken from a millionaire causes him a small loss while the same money distributed among ten poor people will give them a much larger amount of satisfaction.

If there were a large number of very rich people a considerable increase in welfare could be brought about by this means. Unfortunately, the rich are too few. In 1945 there were only 8,000 people with incomes of over £10,000 before tax and after deduction of taxation only 18.8 per cent of this income remained in the hands of its original owners. Taxing the rich now offers few possibilities because the State already takes the larger proportion of their private fortunes. If only there were more millionaires!

Governments have found that it is perfectly easy to make the rich poorer. It is not so easy to make the poor richer. Much has been done in the present century to bring about a position of less inequality in wealth, by taxing the comparatively wealthy for the benefit of the poor and by the provision out of State funds of many services required by poorer people. This policy in its general application is not in dispute. At least since the famous Poor Law of Elizabeth it has been recognised that it is the duty of the State to take care of those who are in great need. Poverty may have various causes and no nation can stand aside and watch any

section of its people starve. Something has to be done in the matter. The points at issue are not the objectives of policy but the means of carrying it out.

It is inhumane to treat the unfortunate harshly, yet it has been proved in the past that it is often dangerous to treat the poor too generously. If the condition of the pauper is made better than that of the normal employed workman, the workman is made better off by pauperising himself. If the State does too much the individual may do too little. It is unfortunate that anyone who recognises these facts, which can be culled from our social history, is stigmatised in certain quarters as being in favour of making the poor starve or some such ridiculous assertion.

Cost of living subsidies

In no matter of social policy is this more true than in the case of the various cost of living subsidies that are in operation at the present time. Those who feel some disquiet at the way in which the policy is shaping are accused of wishing to lower the standard of living of the mass of the population. The matter has become so "political" that it is difficult to discuss it rationally.

The policy was introduced during the war years with the object of stabilising the cost of living index number upon which so many wage rates depended. It was not to stabilise the standard of living—an impossible objective. During a war a large proportion of the resources of the country have to be diverted from ordinary consumption goods to the provision of war-time goods. The diversion of resources and labour to this end means that there is less for other purposes. Hence consumption goods are scarcer, so the standard of living must be lower than in peace-time. This can be reflected in a physical reduction of the quantities of goods available to the people by rationing the consumption, or in a rise in the price of the goods, so that less can be purchased with existing incomes To think that we can spend more resources on guns and still have the same quantity of butter as before is to cry for the moon.

With war-time inflation prices are bound to rise. The price rise is an indication of the real cost of the war. Smaller amounts of consumption goods are available because of the larger amounts of war-time goods that are required. This or any other change in

demand will cause hardship to certain classes of the community. (Hardship will be caused to all classes except to those who do well out of the war. But it will be felt more severely by those whose incomes are not increased or by those, such as servicemen, whose incomes are reduced.)

Therefore the cost of certain basic foodstuffs was stabilised to the consumer by the government absorbing the rise in prices and charging the difference to taxation, or inflation. The cost of living increased by the increased cost of obtaining food either from home or abroad. But the cost was partly borne by increases in taxation and only partly by increased prices over the counter. The cost increased but the cost of living index number was kept down artificially.

Since the war the increased cost of obtaining food has meant that the subsidy, and the resultant taxation, has had to be greatly increased. If the prices were kept down it was believed that wages would also be kept down, thus lessening the inflation which was bound to take place over the method of war finance. By 1944 weekly wage rates had increased by 42–43 per cent over those of 1939 while the cost of living index number had increased by 30 per cent over September, 1939. Whether considering the inflation, the comparatively small increase in wages was due to the juggling with the index number or whether it was due to restraint in making wage demands in war-time by the workers and their leaders, as Mr. Bevin suggests, is a question which is difficult to answer. However, by December, 1947, average weekly wages have risen to 73 per cent above 1939, while the cost of living index number has increased by only 31 per cent in June, 1947, the last date on which the index was published.

A policy which had some justification during the war, and which had a certain limited success then, clearly needs some review in the light of the changed circumstances of to-day. To bring wages into line with the pre-war cost of living index number would allow considerable scope for an increase in the latter. The cost of food subsidies in 1947 was about £400 millions a year, equivalent to about 3s. 1½d. a person each week. The cost of eggs in the summer of 1947 was about 4d. each, of which 2d. was paid to the shopkeeper and 2d. in taxation. Eggs appeared in the official index number as 2d. whereas the real cost, including

that proportion of the taxpayer's income which was taken from him to help pay for his eggs, was double that figure.

Not all foods are subsidised. The chief foods subsidised are bread, flour, eggs, meat, milk, sugar, cheese, margarine, butter, lard, bacon and ham, tea and potatoes. It will be noticed that included in the list are a number of foods whose cost is a small proportion of the family budget, owing to the fact that the quantities which can be purchased are limited by rationing. The butter subsidy of 11d. a pound costs £24 millions and is spread over a ration which is certainly not expressed in pounds weight per consumer. The butter ration varies from 2 oz. to 3 oz. a week. The estimated subsidy on bread and flour is over £88 millions a year, which is one reason why bread was rationed. It was then a comparatively cheap food for livestock.

It must be clearly understood that subsidies do not ensure a certain standard of living. The quantities obtainable are limited by rationing and no amount of subsidy can increase the quantity available. Even if the subsidies were increased so much that the price to the consumer were nil, no one would get any more to eat. In fact the consumer might very well get less because more food would be wasted. In any case, the apparent shortage would be much greater because at nil price people would be very willing to consume more of the commodities.

Non-rationed foods

As only certain foods are subsidised the cost of most other foods is left to the free market. As all people, rich and poor alike, are subsidised the food subsidies represent a subsidy to wages or earnings. This is offset by the taxation required to pay for the subsidy. What amounts to an increase in purchasing power available to the wage-earner cannot be spent on the rationed foods so it is spent on non-rationed items. The price of these other foods therefore rises. The family budget is not decreased because of the subsidies. Money is spent in different proportions on the available commodities. The reason cauliflowers are dear is because cheese is artificially cheap. Purchasing power which is saved on subsidised foods forces up the prices of other goods. A reduction in the subsidies would cause the cost of certain foods to rise to the consumer. She would have less money to spend on "less essential"

foods. The price of these would have to come down or else the dealers would be left with unsold stocks. The cost of the bare rations absorbs a comparatively small part of the weekly budget, so the overflow of purchasing power due to the increased wages forces up the price of other goods. And the overflow goes into just those markets which are so difficult for the government to control. There are constant complaints regarding the price of fruits and vegetables which the Ministry of Food knows that it cannot control because it is not dealing with homogeneous commodities. So the attention of the government is turned to criticising people in the retail trade, especially those who earn a living by selling from barrows. The real cause of the trouble is the financial policy of the government.

Purchasing power not only overflows into other food markets. As it is dammed back from buying many commodities which the consumer wants it goes into any other place where it can find its own level. While gambling is a natural human failing it is being encouraged by the present policy. According to the White Paper on National Income and Expenditure, 1938 to 1946, personal expenditure on food rose from £1,258 millions in 1938 to £1,650 millions in 1946. (This is for rationed and unrationed, price controlled and free commodities.) In the same period expenditure on alcohol rose from £285 millions to £680 millions and on tobacco from £177 millions to £603 millions. In 1946 expenditure on smoking and drinking was £1,283 millions, more than was spent on food in 1938. The increase in these two items, of £821 millions, is partly due to increased consumption but largely to increased taxation. If there were no food subsidies, £400 millions of taxation could be saved and the consumer could still have over £400 millions extra money in his pocket.

It is no part of the above argument to advocate that it is "wrong" to spend such a large part of the consumer's income on these commodities. But if the present government had set out with the deliberate policy of encouraging an increase of expenditure on smoking, drinking and gambling of all kinds, it could hardly have found a better way to do it.

Increase of rations increases subsidy

The policy of subsidising foods has one peculiar result.

When supplies of subsidised foods are limited to what can be brought into the country in war-time the cost can be fairly accurately calculated and it will not vary greatly. But when supplies are increased the total cost of the food subsidy is also increased. The cost of living index number will rise or taxation will have to be increased to cover the additional cost of foodstuffs. The subsidy on butter being 11d. a pound and costing £24 millions, a doubling of the ration would cost the Treasury a further £24 millions. If, however, the margarine ration were doubled it would cost the Treasury only £7 millions. Whatever the consumer may think it is better from the Treasury point of view to feed the people on margarine rather than on butter.

When the Ministry of Food is considering the purchase of an increased quantity of food it not only has to watch the cost in foreign exchange but to watch the effect on the internal finances. (Or, rather, the Treasury will watch the latter cost.) It may be that many consumers would be willing to buy an extra pound of butter at 11d. a pound more than they are paying at present. But they do not have the opportunity. In that case it would cost 2s. 3¾d. a pound as opposed to 1s. 2½d. a pound in 1914. The majority of wages have increased by more than this proportion since 1914.

The effect on the cost of living index number had also to be watched and the government was put to some peculiar subterfuges to keep the index number steady. It was explained in the House of Commons on the 24th March, 1947 that since bread rationing was introduced the consumption of potatoes had increased. The low price of potatoes (which received a subsidy of nearly £20 millions) was encouraging people to feed potatoes to animals, which is only to be expected. So potatoes were increased in price by 1d. per 7 pounds. This had as much effect on the index number as a variation of 3d. a pound in cheese. So the price of cheese was reduced from 1s. 1d. to 10d. a pound. The reason is the "weights" used in the index number were not the quantities of the existing rations but the quantities which were consumed at some other date. So the subsidy on the small ration of cheese was increased (to balance the increase in potato prices) to prevent people from feeding potatoes to animals. (Since that date potatoes had been rationed and de-rationed and

the cheese ration has been reduced.) At the same time coffee was increased in price because it does not figure in the cost of living index number, although coffee consumption has greatly increased due to tea rationing. The whole position is crazy; prices are altered, not in accordance with changes in costs but to juggle with an index number.

False picture

The great objection to the present policy is that it presents a false picture of the true position. Apparently certain foods are cheap compared with the rise in wages. Increased amounts can be spent on amusements. There is more leisure to enjoy these amusements. All these things are very desirable in themselves. But this increase in real wages (the greater spending power available) is a mirage. The real cost of living is the cost of obtaining the food and clothing we consume. It is the cost of the goods and services we have to produce in this country or which we have to acquire from abroad out of the proceeds of the goods we send to other countries. Measured in terms of effort the *real* cost of living is very high. The cost is high because it is not being fully paid for. In the past two years it has been borne by American and Canadian loans and gifts. In 1948 we ate Argentine railways. *The real cost of living* must be measured by the extent to which we are running into debt and mortgaging the future and living on the proceeds of past savings and investments in other countries.

This is not unknown to the government. Truthfully it can say that it has exhorted the people and explained in White Paper and newspaper advertisement the true facts of the position . . . to those who are interested enough in economics to study the question. But the average man is not interested in economics. He is not a specialist. In spite of what the hoardings tell him he *knows* that he is better off. He knows that his wages go further than before. He is quite aware that if he works overtime a large proportion of his excess earnings will be mulcted from him in taxation immediately. The man in the street knows that with the rest of his money, if he is a law-abiding citizen, he cannot get one extra ounce of butter or cheese. The government is pursuing a policy of telling the people the unpalatable truth

and then spoiling it all by presenting a "rigged" cost of living and subsidising the *apparent* cost of living so that the truth shall not hurt. The reasons advanced all point to a dangerous situation in our economy, the actions all point to a position of security and well-being. On one hand the citizen is being treated as a rational and intelligent human being, on the other hand he is being treated as a child who must be shielded from the realities of life.

Subsidies and taxation

It is asserted that the value of the food subsidies is equivalent to 12s. 6d. a week to the average family of four, so that if subsidies were abolished there would be an increase in the cost of living. If they were abolished there would be a readjustment of expenditure. More money would be spent on the present subsidised commodities and less on the non-subsidised. The price of the unsubsidised foods would fall because of the lessened demand. So there would be a reduction in the cost of living of certain items. Further, taxation would be saved. Even if the cost of goods on the average were increased there could be more money in the pay packet, as the expenditure on subsidies is equivalent to 3s. in the pound on the income tax. Large numbers of wage-earners could come outside the income tax paying class altogether by a sharp increase in the allowances. Not only would there be no net loss, there would be a net gain. Subsidies do not just involve the costless transfer of 12s. 6d. from one pocket to the other. There is the cost to the government and to the nation of collecting the taxes and the cost of paying out the subsidies. Both costs would be saved. By reducing the £400-odd millions of subsidies the savings in taxation would be more than this. Businesses would have to employ fewer people on tax-collecting, so their costs would be less. The pay packet would more truly represent an epitome of the true position of the country.

It is objected that certain people would lose more in the abolition of the subsidy than they would gain in the lowering of taxes. In particular, people living on small fixed incomes would suffer. While that is true it is not the point. There is no need to subsidise *everybody* because some are poor. The treatment of poverty is quite a different matter from that of a general subsidy on incomes. The remedy here is to increase the incomes

that are below a certain margin. The more that can be saved on a general bounty the more generously can the country afford to treat those of its citizens who are unfortunate. The loss caused to old age pensioners, for example, could be offset by increasing the value of the pension by 3s. a week. There would also be the gain caused by a reduction in the price of unsubsidised foods. The loss caused to wage-earners could be offset by lower income tax, especially on overtime earnings. As extra work would give increased earnings the relative advantages of work and leisure would alter. This should stimulate production and lower costs. And all classes would benefit by the fact that the true cost of living was shown.

Reduction of subsidies

While it is possible for a government to guarantee that certain people will be able to maintain a specified standard of living, it is unable to guarantee a certain standard to all people. The standard ultimately depends on production and no government can guarantee the total output of goods and services that make up the standard of living of the country. Subsidies for all do not guarantee a real income for all. Only by increased production can the standard rise and anything which holds back production will prevent a rise in that standard. Security for all is a vain endeavour. A temporary security can be obtained by living on capital at the expense of the future. This is no policy for the permanent improvement of the living conditions of the country.

The sudden abolition of food subsidies would cause a disturbance to the economic system. It is not the lack of subsidies but the readjustment which would cause the disturbance. Hence there is no case for the sudden sweeping away of all subsidies. But there is a case for their gradual abolition and for concentrating them on fewer commodities with compensating remission of taxation.

The best start could be made on those commodities which are so scarce that they hardly figure in the domestic budget. Over £17 millions could be saved by the abolition of the subsidy on the bacon and ham that occupy only a microscopic portion of the family breakfast plate. The reduction in the subsidies on bread and potatoes would stop the use of these commodities as animal foods. Less would be thrown in the dustbin.

It was suggested in the *Economist* of 20 September, 1947, that if the weekly ration of butter and margarine were covered solely by margarine, butter could be sold unsubsidised and unrationed. In the first few months its price would no doubt be nearer 5s. a pound than its present level. But within a year the competitive power of New Zealand and Australia would soon bring Danish prices to a more reasonable figure. There is no justification for subsidising both butter and margarine. This is particularly so as those who would feed us on calories instead of on food assert that present-day margarine, owing to its being vitalised, caloryised, etc., is superior to natural butter! If that is so the temporary subsidy could be concentrated on the margarine.

Whenever the ration of a food has to be reduced to negligible proportions opportunity should be taken to withdraw it from the ration and subsidy list and to leave it as an uncontrolled commodity to serve an incentive purpose.

The same arguments apply to other subsidised commodities. It is ridiculous that certain scarce articles of clothing or household equipment, because they come within a "utility" range, should be subsidised, while at the same time other and very similar articles which are non-utility should bear high rates of purchase tax. If the high rate of purchase tax is necessary to "mop up purchasing power" and to pay for government expenditure, then there is little justification for subsidies on various commodities. Because these subsidies add to the surplus purchasing power and help to cause the heavier government expenditure. One piece of cloth is subsidised to make it cheap so that people can buy it and a similar piece is taxed so that people will not buy it!

Sir Stafford Cripps was asked at Bristol why curtains on dockets were sold at 5s. 11d. and off dockets at 18s. 6d., and he is reported to have said that "That should not happen." The reason why this does happen is that nearly all utility materials are on dockets and the cost is often subsidised. These materials can be purchased only by the privileged docket class. Other people have to buy non-utility goods at a higher price and also pay purchase tax in addition.[1] Sir Stafford is quite right in his assertion that "That should not happen" and the remedy is in his own hands.

[1] *See Drapers' Record*, 6th March, 1948.

CHAPTER XIV

FUTURE POLICY

THE preceding chapters have touched on some of the aspects of price control. It is now necessary to bring together the matters discussed and to point to what general conclusions we can and to mark out the lines of future policy.

There are two main approaches to the problem. There are those who are in favour of a large amount of detailed price control in general, to whom the arguments of this book will not appeal. There are those who feel that the price system if left to itself would in general correct any errors in the economic system. If there are specific problems which cannot be solved by the normal market mechanism, such as that of extreme poverty, then corrections should be applied by the State at these particular points.

Normal times

There is a half-way stage. Many people believe that in normal times price control does more harm than good but at the present moment price control is necessary because of special circumstances. These people therefore agree with the criticism of price control. The difference of opinion is that the time for the removal of controls is not yet. With this point of view it is possible to feel a considerable sympathy. If the arguments are conceded the rest is a question of time and those who prefer to wait are still theoretically on the side of the angels.

It is universally agreed that a certain amount of control is necessary in war-time. Then the conditions are special. Now the war is over there is not the need to devote resources to the production of war ends but to devote resources to the multifarious ends of peace-time. What are the special circumstances which justify the retention of price controls?

The economy is disjointed. Resources at the end of the war are placed where they will do most good if the war continues. To change over to peace-time production will mean that factors of production have to be withdrawn from their war-time uses

and diverted to producing other commodities. All this takes time. Price control can be used to effect the orderly change from one to the other. Further, the loss of wealth caused by war-time destruction of property gives us fewer resources to devote to peace-time ends. Times are not normal.

But times never are "normal." Between the two wars with the special problems of readjustment which were then necessary, "normal" times were pre-1914 war. That was the golden age of normalcy. Now the years to 1939 are either the bad old days or a halcyon period to which we would be glad to return. Our present position must be "normal" in the sense that it is the position in which we are now. If we are poorer as a nation than we once were that is just an unfortunate fact. But there is nothing abnormal for nations any more than for individuals to encounter a period when their incomes are reduced. People living on fixed pensions or on the income from investments in British Railways are quite aware of this. With nations as with individuals it is a question of cutting the coat according to the cloth and of living within a restricted income. To ignore this fact and to believe that there is some normal standard of income which *must* be achieved is to indulge in self-deception.

Present "shortages"

Sometimes the reason advanced for price control as a temporary measure is that we are encountering shortages and scarcities in our everyday life. This is an argument which is much in vogue at the present moment. "Due to the shortage of so-and-so . . ." "Owing to the world shortage of such and such a commodity . . .," etc. Was there ever a time that there were no shortages? The whole point of the economic problem is that our resources at any time are insufficient to satisfy all our needs. If we have more of A, we must have less of B. The more wood pulp we devote to the manufacture of artificial silk the less wood pulp will be available for the manufacture of paper. If our resources were doubled, if all our incomes in real terms were doubled, we should still have to pick and choose between the different ways of spending our income. As man's wants are apparently insatiable he will always be short of something. If anyone believes that the reason why newspapers are much

smaller than before the war is because of an absolute shortage of newsprint, he ought to get a copy of the average American or Canadian paper or even a copy of an Irish newspaper. We may be short of the exports to buy wood pulp but this is not a shortage of pulp. The question of shortage is a comparative one. Shortages there will always be and the price structure measures man's evaluation of different shortages.

It is common to divide the factors of production into the fourfold division of land, labour, capital and enterprise. There is no shortage of land, the natural resources are what they were. There is no shortage, in an absolute sense, of labour. Out of a population of nearly 50 millions we have a working population of nearly 20 million. Expressing it in terms of an average family of five, two are working, father and one child living with the family. Owing to a lower rate of unemployment we have a larger population actually at work than before the war. There is no shortage of labour.

It might be said that although there is no absolute shortage of labour, there is a shortage in the sense that labour is in the wrong jobs. Either labour is producing the goods that the community wants (hence there is no shortage or misdirection of labour) or the labour is producing the goods that the community does not want. If labour is in the wrong jobs the cause of this is the very price control that is imposed as a measure for readjusting the supply of labour. As the price of necessities is controlled rewards in those industries are lower. People can secure higher rewards by moving into other industries. If consumers really want more clothes and fewer dog tracks then they should be able to spend more on clothes. Rewards in the clothing industry would rise and consumers would have less to spend on dog racing so that rewards would be reduced in that industry. People would be driven out and more resources would be available for the production of clothing. As it is, nobody knows how people would spend their money if left to themselves. As they cannot spend it on clothing they spend it on something else. The growth of what are called the luxury and amusement industries is a direct result of the price policy with regard to the essentials of life.

But it is asserted there is a shortage of labour due to shorter working hours or in some industries to a reduced output per

man. Shorter working hours and the refusal to work overtime is a reduction in effective work as distinct from the numbers of workpeople employed. If that is so—and there is a disposition to blame the workman for the shortcomings of our controlled system—what else is this but choosing between the alternatives of work and what the money earned from the work will buy and the alternative of leisure? The price and tax structure weighs heavily against increased effort. Leisure may be preferred because, as Adam Smith points out, "It is better to play for nothing than to work for nothing." Leisure is one of the few commodities which is not taxed and the workman who prefers leisure to overtime at a high marginal rate of tax cannot be accused of stupidity.

If the government wishes a higher output of goods rather than a higher output of leisure then it should adjust its own policy accordingly. But by subsidising the cost of living and by pretending that it can guarantee a certain standard of living to all irrespective of production, it is destroying the incentive to produce more. The British workman is only the British soldier out of uniform and, properly led, he is the best in the world. The trouble is he is not led. He is cajoled and flattered. He is presented in his personal budgeting with a false position of the real state of the nation and then exhorted to work overtime. The policies of bread and circuses and taxes on overtime are not conducive to extra work.

Shortage of capital

While there is no shortage of labour in the absolute sense (an "overall" shortage in the modern jargon), it is true that there is a shortage of capital. Resources were destroyed during the war. Equipment was allowed to run down. Resources were diverted to non-peace-time pursuits. The remedy here is quite plain, which is to increase the capital resources by saving out of current income. The fault with the present position is not that we are investing and rebuilding the capital equipment too much but that the necessary savings to finance this re-equipment are too small. Most of the personal savings in the country come from the relatively rich. But as they are being highly taxed, in order to maintain their current consumption, they have to economise on savings.

People save for a variety of motives and people will save more when they believe that their savings will be secure. The past saver, who has invested money in railways, electricity and gas undertakings and who has suffered a considerable loss of income when these industries are nationalised, cannot regard future investments as being quite so secure as they were in the past. When it is proposed in some quarters that the steel industry should be taken over without compensation to the existing owners, is it any inducement to anyone to cut down current consumption to invest money in the steel industry? There is a direct inducement to follow the advice of Omar Khayyam to take the cash in hand and let the credit go. The effect of the fall in savings on inflation will be considered below on page 206.

Shortage of enterprise

There is also a shortage of the factor of enterprise and this is due to government controls. Many trades, whose methods of production and distribution are controlled through certain specified channels, are getting into a position of inertia. Here the importance of the merchant with his specialised knowledge is overlooked. Whereas pre-war the success of a business depended on an informed buying policy and on a knowledge of the commodity, now a great deal of that knowledge is being lost. New entrants to business are not getting an adequate training. No longer is it necessary to choose the commodities wisely, as the business sells what the Ministry sends it. People within different trades speak of the complacency into which the trade has fallen. Holders of Ministry quotas do not have to think for themselves. Cost-plus contracts encourage rising costs of production. Exporters who are unable to hedge their supplies of raw materials are unable to give firm quotations. Production and trade just do not happen by themselves. They happen because manufacturers and merchants want them to happen and because there is some inducement for traders to want these things to happen.

Overseas balance of payments

One of the dislocations due to the war has been in the overseas balance of payments. The sale of part of the investments made abroad has caused a diminution of the income receivable

from that source. We no longer can obtain commodities from abroad paid for out of interest and profits derived from past investments. As a nation we are in the position of an individual who, in addition to his earned income, is in receipt of a private income from investments. The investments have largely gone and it is necessary to reduce the pattern of expenditure to the existing income. It is a reorganisation which has often enough to be performed privately as well as publicly. It is rather interesting that this position has been inherited by the present government, whose followers have generally expressed themselves as opposed to the recipients of unearned incomes and profits. The gods must laugh to see the Socialists hoist with their own petard.

The complaint is made that there is a shortage of dollars with which to buy imports from the Western Hemisphere. "No complaint is more common than that of a scarcity of money. Money, like wine, must always be scarce with those who have neither wherewithal to buy it nor credit to borrow it," as Adam Smith reminds us. A large part of the scarcity of dollar money has been provided for this country by the American taxpayer in the form of the American loan. Canadian dollars have been provided by loan and gift. Never before have we had so much money provided for nothing! Further dollars have to be provided by our doing without resources at home in order to export commodities which will earn dollars. If people are in the wrong industries at home they are unable to be in the right industries which will earn foreign exchange. Inherently the position is quite simple. If we wish to buy from abroad we must as a nation provide the rest of the world with the commodities which they want in exchange. Either we rely on our own resources and are satisfied with the product of our own soil or we exchange part of our product abroad. But we cannot have the goods from abroad unless we are prepared to provide the rest of the world with some of our products.

The British colonies can provide many commodities which will earn a large number of dollars, yet the government controls the price of tin and juggles with the home price of cocoa in relation to the New York price and generally makes it difficult for dollar-earning industries to get going.

It must be remembered that the necessary exports are provided by private firms, the coal exports being at the moment

a negligible figure. Also that a large proportion of the exports of this country are in small consignments sent by individual merchanting businesses. Yet it is these firms, the quintessence of private enterprise, that meet with the greatest degree of government disapproval and are most badgered by regulations and controls.

One of the most disquieting features of the export trade is that for the first time there is an adverse balance on the Invisible account. The figures, for what they are worth, show that on balance we were paying out abroad in 1947 more than we were receiving from abroad on the "service" items. Part of this loss is the deliberate policy of the government. Britain as a great trading, commercial, banking and insurance country earned large sums from abroad from the services provided by her merchants. The closing of the Cotton Exchange has lost us the overseas earnings of that institution. There are the other markets still closed which, if reopened, would allow merchants to earn foreign exchange. But while the merchant is in official disrepute we are denied those earnings.

Domestic inflation

Controls are advocated as a means of stopping inflation. "Anti-inflationary" as a term has almost reached the blessedness of the word Mesopotamia. The government must increase prices by means of purchase tax, decrease prices by means of subsidies, keep prices where they are by price freezing Orders, all in the supposed interests of a policy of curing inflation. ("Too much money chasing too few goods.") We were led to believe that a main reason for the nationalisation of the Bank of England was that the government would then be able to control the financial system of the country and that a Labour government would no longer have to fear a "banker's ramp." Yet one of the primary duties of a government is the protection of the currency. A depreciating currency is the mark of all inefficient governments.

The latest theories of the economists are always acted upon by the government . . . a generation later. The Great Depression coloured all economic writings since the publication of Keynes' *General Theory*. According to this theory unemployment is caused by a deficiency of purchasing power. People save part of their incomes instead of spending them. The money saved is withdrawn from the economic system, thus causing purchasing

power to be deficient. The man who saved caused unemployment. Therefore it is the duty of the government to make up for this deficiency of effective demand by engaging in public works. So now we have an excess of purchasing power and over-full employment. Too much money is spent.

One reason why there is too much money is that government expenditure is excessive compared with the savings of the country. Whatever comfort could be obtained by a competent accountant from the Budget "surplus," aggregate money expenditure, including capital items, exceeded aggregate money receipts. The inflation causes the shortage of goods. Spending power is increased at a greater rate than the expansion in the production of goods. Consequently there is a strain on the economic system. Sir Hubert Henderson is of the opinion that the excess of demand in the system is probably responsible for a greater waste of productive power than resulted from the deficiency of aggregate demand in the nineteen-thirties.[1] And Mr. R. F. Harrod has very clearly explained the relationship between the excess of capital development over savings as a primary cause of the overseas excess of imports over exports.[2]

Part of this is now ancient history. The government is budgeting for a real surplus to curb inflation; it is telling us that perhaps *we* have tried to do too much at once. And it is cutting its programme of capital expenditure. It is not that the government was doing too much in the sense that the expenditure was unnecessary. Item by item all the expenditure was desirable and the same could be said for business expenditure on capital development. But the expenditure was excessive in relation to the nation's savings. Reconstruction development implies that people are going to forgo consumption, i.e. to save. The cause of the trouble is that the savings of private individuals are pitifully inadequate. Most of the authorities lay little of the blame on to the cheap money policy in itself but I think that the government has done much to destroy the will to save. Of all the encouragements to put by for the future a capital levy must occupy a low place!

Against the forces which are causing people not to save and even to dis-save, the government uses the method of exhortation and this is unsuccessful. "It is the highest impertinence and

[1] *Economic Journal*, September, 1947 [2] "Are these hardships necessary?" passim.

presumption in Ministers to pretend to watch over the economy of private people and to restrain their expense, either by sumptuary laws or by prohibiting the importation of foreign luxuries. They are always themselves, and without any exception, the greatest spendthrifts in the society. Let them look well after their own expense and they may safely trust private people with theirs. If their own regal extravagance does not ruin the State, that of their subjects never will." Nothing which has happened in the post-war years has disproved this judgment of Adam Smith's.

As inflation is advanced as a reason for the continuance of price controls and rationing of food and raw materials, the sooner the inflation is cured the sooner can the controls be swept away if the government so wishes. The sooner will the foreign trade position balance itself. The sooner will the commodity markets be free from control, leaving them able to earn foreign exchange which in itself will assist in the balance of payments.

. . . . .

It is now necessary to sum up some of the objections to the present system of price control with its consequent material and labour controls, etc.

Inefficiency of controls

The system does not properly work in peace-time. The economic system is too complicated for people at the centre to regulate the whole of trade. The repercussions of any action are felt far and wide throughout the economic system. We are not dealing with a primitive community with a few staple commodities. Control of one part of the system has effects which are unforeseen on other parts of the system. Hence controls tend to be extended and the more they are extended the more they become contradictory.

Firms have been fined for making too much profit, yet they have sold below the maximum prices laid down in the price control Order. Where there is a change in the price of the raw materials the price Orders become obsolete. There is difficulty in getting the Orders revised to suit changing circumstances. When the subsidy on leather was abolished boot repairers asked for an increase of 3d. to compensate for the higher cost of

leather. The government allowed an increase of 1½d. on the cost of leather repairs (which was insufficient) and an increase of 1½d. on rubber repairs (which was unwanted and unasked). There is a comparatively free market in rubber. Where prices are insufficient firms are driven out of existence; where prices are excessive inefficient firms are allowed to make good profits and use up scarce resources.

The control of what are considered "necessities" drives purchasing power into "luxuries" and the increased purchasing power there attracts resources into those activities so that the economy becomes unbalanced. It is then considered necessary to control the luxury activities so that there is no end to the interference in private life.

Respect for the law

As the system does not work properly it does not command respect. Each time that there is a breakdown in the controls on the individual the leak has to be plugged up, often in an arbitrary manner. Price control means that people cannot have what they want. If they could do so there would be no necessity for price control. The controlled price is an arbitrary government price. The "black market" price is the true economic price, arrived at by the operation of the existing supply and demand. Where willing buyers and willing sellers are prepared to deal at a price above the government price there is a lack of respect for the government price. As the government price is supported by the law, the law is regarded not as the protector of the individual but as a persecutor. Before the war the vast majority of the population would scorn to break the law. Or if they did break it they did not consider that it was something creditable to themselves. There are few people nowadays who are immune from the temptation to something extra on the rations or who are not willing to slip a tradesman a *pourboire*, an addition to the price, in order to get some price-controlled commodity. Although the ultimate sanction for a country's laws lies in the armed forces, the whole system can operate only if the majority of the people believe that the laws are just. The disrespect which is felt for the laws regarding price control is extended to other laws as well. The more that people believe that the laws are stupid, the more they are induced to break them. The more

stupid laws that are in operation the more do people lose the respect of the laws which are still valid.

A glance through various trade papers will show that much of their limited space is taken up in explaining the various regulations which are introduced, withdrawn and amended and with reporting Court cases where traders are being punished for breaking regulations, many of which they are unable to understand. Business is no longer business but a constant endeavour to avoid the consequences of the regulations.

The law is further brought into disrepute where *agents provocateurs* of the government induce traders to break the law so that the latter can be punished for listening to the blandishments of the inspectors, as frequently happens in café and restaurant cases.

Arbitrary effects

Price control is most arbitrary in its effects on different classes of the population. Fixing a low price is of benefit to the buyer and of disadvantage to the seller. Wealth is transferred from one person in the community to someone else. This in itself is not necessarily a wrong policy. But the proper method is by general taxation, not by the arbitrary method of controlling the commodity irrespective of the relative positions of buyers and sellers.

Where the seller is a poor person he is being controlled for the benefit of someone better off than himself. A poor man who has invested his savings in house property is forced to subsidise the wages of a comparatively well-paid workman who is able to obtain advances in wages to compensate for the depreciation in the value of money.

Price control is imposed on Harris tweeds, which are produced by poor people in their own cottages but which are used by the comparatively well-to-do in this country and abroad. The full majesty of the law is invoked to hound, among others, old ladies well over the normal retiring age who are trying to supplement their incomes. Many of these workers are unable to read English and, in common with many better educated people, are incapable of understanding the language of the many Orders which are directed against them.

Dividend limitation, even where "voluntary," affects people

living on small savings. It affects people who are too old to work and too proud to beg, and the only result of ruining them would be to necessitate an additional expenditure on poor relief. This expenditure would have to come out of the incomes of the wage-earners.

Effect on the national income

Price control, material control and rationing, all lower the national income. The rations have to be average rations and there is no average man to consume them. Certain rations to many people are less than they would like; other rations to the same people are more than they want. Even the small meat ration is excessive to a vegetarian; perhaps he would prefer more clothes instead. The hearty meat eater may find that the clothes ration is more than adequate for his tastes and station in life. An even distribution of commodities lowers the personal satisfaction where people would prefer an uneven distribution. The same quantities of commodities would provide more satisfaction and so increase the national dividend if they were distributed, through the price mechanism, into the hands of people in accordance with their own scales of preference. "What is one man's meat is another man's poison" but we are all entitled to the same ration of meat and poison.

National production is increased, i.e. people obtain the utilities they want, if a given quantity of resources is distributed among the people in proportion to their demand for the commodities in being; to allow the same quantity of goods into the wrong hands is not economic production, whatever the overall figures of output may be.

These controls all lower the national income in another way by diminishing the incentive to produce. While people in certain industries are being urged to increase production in the national interest they are being offered nothing in return. It is a unilateral transaction. If a miner worked twenty-four hours a day, if the output of coal were doubled, the country would benefit greatly. But the individual miner could not buy one single ounce of butter extra to his ration. Once people have earned sufficient to buy the subsidised means of existence there is little incentive to earn extra taxed income, as no extra rationed goods for the table may be purchased. The diversion of the extra money into

the non-controlled sector of the economy and the satisfaction which may be obtained there is not sufficient to offset the lack of incentive in other directions. It is not surprising that the utility of leisure occupies such a high place.

If there were more freedom in the economy and the rationing system were confined to those commodities that were in genuine world shortage (as distinct from those commodities we cannot buy because there are insufficient people in our export industries to pay for them), there would be some incentive to produce. All initiative has not yet been taken away from the British character.

Misdirection of energy

The present system of controls causes a double misdirection of energy. One is not entitled to ask for a system of price and material control administered from the centre and to complain of the "hordes of civil servants." If one is a believer in a system of control there is no justification for the complaint that there is a shortage of labour. Nor that there is a shortage of housing when the government offices occupy premises that are suitable for private occupation.

No estimate is possible of the number of people who are employed because of the controls. In addition to the increase in the numbers of people employed directly by the central government in such departments as the Ministries of Food and Supply, there have to be added the large numbers of people employed by local authorities in carrying out the Orders emanating from the central government. There is also in industry the diversion of manpower to the task of trying to understand, to comply with, and perhaps even to defeat, the unending flood of Orders and counter-Orders.

It used to be said that one of the great disadvantages of tariffs in international trade was that producers diverted their energies from the manufacture of goods at low prices to "lobbying" for brighter and better tariffs. More money could often be made by obtaining an addition to the tariff than by lowering the cost of production. Under a system of control resources will be devoted to defeating the controls by producing a slightly different article or by enforcing conditions of sale or by lowering the standard of the article.

Lack of progress

Controls tend to perpetuate the *status quo*. Industry is kept within certain well-defined channels. Only certain commodities may be produced at certain prices. An improvement in the standard of living necessitates a progressive economy. We are preserving the existing standard at the cost of never obtaining a better. If we had achieved the ideal state and if no improvement were possible, if everything were happening for the best in the best of all possible worlds, there would be some justification for the policy of preserving the existing situation. But few would agree that we had reached the highest standard possible. Therefore a change from the existing state is desirable and controls prevent that change.

Opposing policies

A contradictory policy is being pursued. People are paid in money and then not allowed to spend it as they would wish. While the trade unions believe in unequal pay ("existing wage differentials"), we are endeavouring to provide an equal standard of living. Purchasing power depends not only on the amount of money which is earned but on ability to acquire coupons and dockets and on the time and energy to stand in queues. Money is used as an incentive carrot and coupons as a prison bar.

If coupons and dockets were allocated in proportion to work done, then the coupons would be incentive goods. But money is only a single comprehensive "coupon," allowing us to choose any commodity we want. It is a form of points rationing. Money has not yet lost its function as an incentive good, otherwise people would not want higher wages. Consequently, if the price system were allowed to function more freely there would be a greater incentive to produce because people could use the money for whatever purpose they wished. The function of money is that it can be spent on the goods and services that people require.

It has been pointed out that in the furniture trade people who had the money to buy had no dockets and the people with the dockets had no money. People moving into a new house are entitled to have a bath fitted but people living in an

old house are prevented from converting a spare bedroom into a bathroom.

Control over people

While price control is expressed on goods it is eventually on people who are workers and consumers. The control of the price of an article is a control on the makers of that commodity and on the people who wish to buy it. The rationing of bread is a rationing of people's consumption. It is an arbitrary regulation as to how people are to spend their incomes and how they are to satisfy their hunger. In the last resort price and rationing controls are devices to make people follow a certain pattern of living. Control of the profits of companies is a control of the income of the owners of the companies, irrespective of the incomes of the individual shareholders.

Workers and their trade unions are well advised to reject government control and fixing of wages. They are quite capable in this country of looking after their own interests without government direction. But the same freedom which workers rightly demand for themselves should be as freely accorded to other sections of the community. The political consequences of too much centralised control may prove disastrous to freedom.

The effect on government

The pettifogging interference with every detail of life is not only bad for the individual, it is bad for the government. The time of Ministers is so clogged up with, *inter alia*, fixing the maximum prices of dartboards, that the government has no time for real government. Administration becomes less efficient. It is a sign of the times that the "*laissez-faire*" school which is supposed to be opposed to government intervention has to come to the rescue of the government machine. By advocating not more government but better government we may prevent the government machine from breaking down through its own exuberance. One of the main objections to the extension of government controls into unnecessary directions is that the government has no time to govern properly in the necessary fields. When it pays attention to the small details of commercial life the government does not take proper care of the important and absolutely necessary functions of government, such as the proper control of the currency. If the real causes of the trouble

were put right there would be no need to be concerned with the matters now under discussion. By attempting to cure the symptoms the government is ignoring the causes.

The effect on industry

The harmful effects are not confined to the government. Industry suffers in the lack of initiative. Ministers speak of traders who are content to lean back on the controls and earn a safe living by handling an allocated product at a fixed margin without having to face the rigours of competition. Special skills and techniques are being atrophied through lack of use. What was once a progressive commercial nation is becoming a static controlled nation. The best brains and energies in the country are being devoted to controlling industry instead of to expanding it. Losses which would be ruinous under a commercial regime often fall upon the country without any particular comment being excited.

The transition

At times the advantages of a freer system are admitted but the excuse for price control is that the controls are needed to bring about the readjustment from war to peace. A strong case can be made out for the use of controls to effect an orderly transition in the economy. While the "invisible hand" or the forces of the market will eventually bring about equilibrium, a wise control or a visible hand of direction will do the job much better. Theoretically there is much to be said for this view. A wise and benevolent direction may be better than the clumsy forces of nature. The comparative merits of natural selection and of perfect government may all lie on the side of the latter. But the relative merits of a freer system and of government as it is with busy and fallible men, instead of omniscient supermen, regulating the petty details, may not be so overwhelmingly on the side of intervention.

Can it be said that we have progressed towards a new and peace-time equilibrium? Are we any nearer balancing our internal and our external trading position than we were at the close of the war? No doubt many of the policies have been well-meaning. But the road we have travelled since the war is not the only one which is paved with good intentions.

Not all the controls have the merit of good intentions. There is a disposition in some quarters to ape the Benevolent Despots of the eighteenth century, and to treat the people in a way which is the negation of democracy. "The statesman, who should attempt to direct private people in what manner they ought to employ their capitals, would not only load himself with a most unnecessary attention, but assume an authority which could safely be trusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it," is the judgement of Adam Smith. To-day there are many with the presumption and the arrogance to tell other people, on whose votes they rely, how they are to regulate their private lives.

Nowhere is it argued that the correct policy is the sweeping away of all controls, but a move to a freer system should be started before it is too late. If the budgetary position is put right and if we do not attempt to do too much with our existing resources, the alleged necessity for many of the price controls would disappear. Parts of the economy could be progressively freed from control. Where there is a favourable trade balance with any particular country ("unrequited exports"!) private people should be allowed to import freely. If necessary they could bid competitively at the Bank of England for the available foreign exchange. The more that people satisfied their *own* wants from such sources the less need would there be for the government to buy on their behalf products from countries whose currencies were "scarce." Wealth is increased not only by increasing the quantity of resources available but by allowing existing resources to be used in the manner in which the people really want them to be used.

Laissez-faire

Many people will object to the analysis in the foregoing pages on the grounds that it is destructive criticism only and is an attack on the functions of government. They will say it advocates the outmoded policy of *laissez-faire*. *Laissez-faire* is taken to mean leaving things alone, with the government function helpless in the prevention of abuses.

Nothing could be further from the truth. *Laissez-faire* is in

itself a *positive* policy. It is destructive only in that it seeks to sweep away the hampering effects of bad government so that people may benefit from good government. That policy is much misunderstood to-day and the term is now used more as a term of abuse than as a serious discussion of practical policy. It is well worth our while to examine what was, and still is, the basis of the *laissez-faire* school of thought.

The policy of price control is nothing new. It has not been invented in the twentieth century. All through the Middle Ages the detailed regulation of life was the rule rather than the exception. This regulation kept down wages and limited the movement of labour, and was backed by a serfdom which lasted in many European countries well into the nineteenth century.

Life was relatively stagnant and unprogressive. The expansion of trade was hampered by a multiplicity of controls on all aspects of life. It was the French school of the Physiocrats who pleaded with the government to allow manufacturers the freedom to make what goods they could, unimpeded by the restrictive policies of the Middle Ages. They wanted the government to allow those goods to pass freely (*laissez-passer*) from one part of the kingdom to another without the petty and vexatious duties and octrois that were levied on them as they went from one local government area to another.

The case was taken up by the British classical school of economists, the outstanding figure of which was Adam Smith. His *Wealth of Nations*, published in 1776, did much to prepare the intellectual ground for the abandonment of the restrictive policies. It must be asserted at once that the case for *laissez-faire* as expounded by Adam Smith was *not* that freedom of trade would benefit the interests of the producers. His case was the exact opposite. Freedom of trade meant that anyone was free to enter any occupation he chose and that the resultant competition of the producers would bring down prices to the consumers. His argument was that the pursuit of self-interest, to put it at its lowest, would in general lead to the greatest degree of public interest.

Each man in seeking his own advantage could generally only attain his object by serving the public. The more people that there were seeking a profit by manufacturing a commodity the lower would the price be forced down to the great mass of

consumers. The great merit of competition is that it benefits the consumers.

Neither Adam Smith nor any of his followers made the mistake of believing that this was the end of the story. He was careful to use the word "generally" in describing the merits of a competitive price system. The great merit is that it would work even if we assumed that the sole motive was that of self-interest. The motives of the producers were irrelevant. What mattered was the effect on production and prices.

There are exceptions to this doctrine, as Adam Smith himself was very careful to point out. The self-interest of the monopolist is opposed to that of the consumers. By restricting his output he is able to exact higher prices. But this is not a defect of competition, it is a defect of monopoly. If, therefore, the self-interest of any person in the State acts against the interests of others, there is a legitimate field for government intervention; an intervention to prevent the abuse of monopoly power, not to create it.

He was followed by John Stuart Mill, who advocated that private enterprise be the general rule, and by Mr. Herbert Morrison, who has stated that the proper division between State and private enterprise is 80 per cent for the latter. Mr. John Strachey has frequently extolled the virtues of the free play of economic forces for their power to bring down excessive prices. In fact, modern British Socialism, in its best and most idealistic form, owes much to the Liberal economists and particularly to Bentham's doctrine of the greatest happiness of the greatest number.

Where freedom for one person leads to abuses there is a proper function of the State to interfere. Freedom does not mean the liberty of the highwayman to plunder his neighbours. Certain industries have a natural tendency to develop into monopolies, although their number is much smaller than is commonly supposed. Here there is a duty on the State to intervene to preserve the conditions of competition and to protect the weak against the strong. But the State must beware of the exuberance of its powers and not interfere merely for the sake of interfering. The lust for political power is one of the manifestations of self-interest that is not always in the public good.

The State must be careful for another reason. Even granted the best of intentions, remedial action may do more harm than it does good. "That crafty and insidious animal, the statesman

or politician," in Adam Smith's phrase, is no more gifted with second sight than is vouchsafed to us ordinary mortals. His errors are the more liable to be serious than those of the individual because they cover a more comprehensive ground. While the errors of business men may cancel out, the errors of the statesman may all point in the same direction.

Future progress

A rising standard of living is hoped for by all people in the community. The hope is a result of recent history. But it must be remembered how slowly and how little the world has progressed in the course of human history. Nineteenth-century developments were the exception, not the rule. For ages the life available for the great majority of mankind was solitary, poor, nasty, brutish and short. It was hedged around with restrictions. It is no accident that the Industrial Revolution came first to Britain, where of all European countries the powers of the central government were weakest, so that individual enterprise could have full play.

The vast changes which improved the lot of man were nearly all initiated in this small island, the improvements in textile machinery, the use of coal in iron smelting, the invention and the application of the steam engine, the building of railways and the steamship. All depended on the absence of control and on the freedom of people to make what they liked and to offer it for the custom of the public. And we must not forget that it was the individual enterprise of the working man that built up the trade unions and the Co-operative movement. Both are striking examples of the fact that self-government is better than good government.

Progress, upon which depends the raising of the standard of living of the world, does not come automatically. Inventions are not made passively. They are made and applied by various individuals in a condition of freedom. If we change the conditions that made the progress of the nineteenth century possible there is no guarantee that we shall continue to advance. All historical evidence points the other way. If the early canals had been nationalised by the State, is it believed that the railways would have been allowed to develop and to bring ruin on the State enterprise?

Unfortunately we are rapidly becoming a closed economy. Our price and other controls look to the past and prevent us from climbing to a better future. By relying on a centralised government control we are forgoing the use of the native genius of our people to surmount difficulties. We are ignoring the great advantages of individualism. The late Lord Keynes was a great advocate of the wise intervention of the government in monetary matters but he well knew the great advantages which had accrued to this country through individualism.

"Let us stop for a moment to remind ourselves what those advantages are. They are partly advantages of efficiency—the advantages of decentralisation and of the play of self-interest. The advantage to efficiency of the decentralisation of decisions and of individual responsibility is even greater, perhaps, than the nineteenth century supposed; and the reaction against the appeal to self-interest may have gone too far. But, above all, individualism, if it can be purged of its defects and its abuses, is the best safeguard of personal liberty in the sense that, compared with any other system, it greatly widens the field for the exercise of personal choice. It is also the best safeguard of the variety of life, which emerges precisely from this extended field of personal choice, and the loss of which is the greatest of all losses of the homogeneous or totalitarian State."[1]

In the last article which Lord Keynes wrote in the *Economic Journal* he referred to the same topic of the free forces of the market: "I find myself moved, not for the first time, to remind contemporary economists that the classical teaching embodied some permanent truths of great significance, which we are liable to overlook because we associate them with other doctrines which we cannot accept without much qualification. There are in these matters deep undercurrents at work, natural forces, one can call them, or even the invisible hand, which are operating towards equilibrium. . . ." Further, he stated that we are not to defeat but to implement the wisdom of Adam Smith.

It is a pity that while there is great scope for wise and effective government action the time of members of the government is occupied in devising controls which are harmful to the progress of the nation.

[1] *The General Theory*, p. 380 (quoted from Professor Robbins, *The Economic Problem in Peace and War*, p. 82).

INDEX